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## Research Update:

# University of Western Ontario 'AA' Ratings Affirmed; Outlook Remains Stable

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## Research Update:

# University of Western Ontario 'AA' Ratings Affirmed; Outlook Remains Stable

## Overview

- We expect The University of Western Ontario to maintain robust unrestricted financial reserves levels and healthy liquidity, keeping the debt burden manageable in the next two years.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on Western.
- The ratings reflect, in part, the university's stand-alone credit profile, which reflects our combined assessment of the university's very strong enterprise and financial profiles.
- The stable outlook reflects our expectation that the university will maintain a healthy market position and demand profile, and available resources will remain superior.

## Rating Action

On Feb. 21, 2018, S&P Global Ratings 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.

## Outlook

The stable outlook reflects our expectations that, within our two-year outlook horizon, Western will maintain very strong liquidity, with cash and investments greater than 3x its debt; a healthy enrollment and demand profile; and robust consolidated financial performance. The outlook also reflects our expectation that the university's relationship with the province will be stable.

## Downside scenario

We could take a negative rating action if, in the next two years, the ratio of cash and investments-to-debt were to decrease below 3x and available resources erode materially; or changes to ongoing funding (either operating grants or research funding) weakened Western's budgetary performance such that adjusted net margins deteriorated to less than 5%. Evidence of negative government intervention from the province, a strengthening of our assessment of the link between the university and province, or a significant reduction in our assessment of Western's resilience to an Ontario default scenario could also cause us to lower the ratings, potentially to on par with or below those on Ontario, depending on the severity.

## **Upside scenario**

A significantly improved enterprise profile, with a selectivity ratio below 50% and increased geographic diversification of the student body, with out-of-province students accounting for more than 30% of total FTEs, could result in a positive rating action, in the next two years.

## **Rationale**

The ratings on Western reflect the university's stand-alone credit profile (SACP), which S&P Global Ratings assesses at 'aa' based on the university's very strong enterprise and financial profiles. The enterprise profile reflects a healthy enrollment and demand profile, strong management and governance practices, low industry risk, and Ontario's extremely strong economic fundamentals. We base our assessment of the university's financial profile on Western's robust financial management policies, history of strong financial performance, and high levels of cash and available financial resources. In our opinion, the university's relatively limited geographic student draw; its moderate debt burden; and the leveling-off of provincially funded undergraduate spaces, which could affect operating grants in the medium term offset these strengths somewhat.

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, based on our view of its important role and strong link with the province. Our ratings on Western are above those on the province, reflecting our estimate that, along with the university's independence with regard to ownership and operations, its financial assets are sufficient such that it would likely not default on its obligations under a provincial stress scenario in which all government funding was temporarily disrupted. Although we expect that operating grants from the province will evolve through changes to the funding formula, we do not expect a material decline in the overall level of support to the university in the next two years.

Founded in 1878, Western is a research-intense, doctoral university. It is in the southwestern Ontario city of London, which has a population of about 384,000. Western has about 33,051 full-time equivalent (FTE) students on its main campus (and close to 38,700 FTEs with its three affiliated colleges). The university has 12 faculties and schools, including a school of medicine and dentistry, law, engineering, and business. It also has affiliations with three research institutes, three university colleges, and two teaching hospitals.

We believe Western has a very strong enterprise profile. Supporting this view is our assessment of the higher education sector's low industry risk, with counter cyclical and low competitive risk and growth. In addition, the university benefits from excellent economic fundamentals, measured by the province's GDP per capita, which we estimate at over US\$49,000 in 2017; good income indicators; and moderate employment and population growth projections.

However, because a high proportion of students (77%) are from Ontario, Western's student draw has, we believe, limited geographic diversity relative to that of some peers.

We believe the university's credit profile benefits from a healthy and fairly stable demand and enrollment profile. Western benefits from solid student quality metrics; a robust selectivity rate below 60%; excellent first-year retention rates of over 90% in recent years; and exceptional faculty quality, with substantially all faculty members having PhDs or equivalent degrees. Headcount has increased modestly in the past several years. However, the university has budgeted for flat undergraduate FTE growth and will focus its enrollment growth efforts on attracting more international and graduate students, although competition for these students is high. The university is a member of the U15, a group of leading research-intensive universities in Canada. In fiscal 2017, it received C\$243 million in research-related grants and contracts, which have been slowly increasing in the past several years. Western has raised almost the entire C\$750 million under its current fundraising campaign, launched in 2007, demonstrating effective fundraising capacity.

The university's senior administration has been largely stable. In our view, it has sufficient depth and expertise, and has demonstrated consistent operational effectiveness, which we believe lends stability to the credit profile. Overall, we view Western's transparency and disclosure to be good, with policies and procedures in place to adequately mitigate risks. The university conducts its activities according to a four-year operating and capital plan that contains what we view as appropriate assumptions. It prepares externally audited financial statements, which have been unqualified; and it has formal policies for endowments, investments, debt (which includes benchmark targets), and reserves (including a minimum operating reserve balance of C\$7.5 million).

In our opinion, Western has a very strong financial profile, largely in line with the medians for 'AA' rated public colleges and universities. Its adjusted weighted average operating margin was 8.1% in the past three fiscal years because enrollment growth has been stronger than the university had forecast, resulting in higher tuition revenue. Western's operating fund budget, which looks out to fiscal 2019, forecasts that revenue growth will come mainly from tuition revenue while provincial operating grants will be flat. The budget anticipates deficits in fiscal years 2018 and 2019, largely due to between C\$57 million-C\$70 million in one-time strategic allocations, and Western plans to fund these deficits through its operating reserve, which has a balance of C\$64.2 million at the end of 2016-17. The operating reserve has a board-mandated floor of C\$7.5 million at the end of the four-year budget plan and we believe that the university would defer some of the one-time spending in order to maintain this minimum.

Along with the potential for lower government grants, the university will face ongoing operating pressures primarily related to the tuition framework, and increasing employee-related expenditures. Similar to that of Canadian peers,

Western's limited flexibility to increase its student-generated revenues somewhat offsets its financial performance strength. This is primarily because Ontario monitors and guides domestic tuition rates and student aid (through the tuition framework), and enrollment expansion (through operating grants).

In our view, the university has a relatively moderate debt burden. At fiscal year-end 2017, its total gross debt outstanding stood at C\$288 million. The debt consists of C\$5.1 million in bank debt; a fixed-rate, C\$190 million, 40-year bullet debenture due 2047; C\$7.4 million in mortgages; C\$11.2 million related to Western's research park; and C\$75.1 million in amortizing banker's acceptances (outstanding from a C\$100 million non-revolving facility that matures in fiscal 2027). In addition, the university issued a C\$100 million, 40-year bullet debenture due 2057, in December 2017 for its capital requirements. We view Western's debt structure as aggressive as more than 50% of its total debt is non-amortizing; however, the bullet maturities are years away and the university's strong liquidity partially mitigates the associated risks. To help repay its bullet debentures, Western also plans to set aside C\$30 million in an internal sinking fund by end of fiscal 2018. Our estimate of Western's maximum annual debt service (which includes an estimated principal component for non-amortizing debt) equals 3.1% of our adjusted fiscal 2017 expenses. In our view, the university's debt burden is manageable given its good operating performance and the healthy level of available resources equal to 2x debt based on a three-year weighted average basis. It does not expect to borrow any additional external debt in the next several years and we believe that debt service coverage will remain more than adequate throughout our outlook horizon.

Among Canadian rated universities, Western is the only one to sponsor a pure defined contribution pension plan for current employees that shifts the plan's investment risks away from itself. This contrasts to some institutions that face the potential requirement to make special solvency payments on their pension plan deficits. The university has a legacy defined benefit plan that was in a very modest surplus position of C\$1.06 million at fiscal year-end 2017, and we do not consider the liabilities associated with this plan to be significant.

The majority of Western's postemployment liabilities relate to unfunded nonpension benefits such as medical and dental. At fiscal year-end 2017, these liabilities amounted to almost C\$473.5 million, down 10% from the previous year. Because there is no legislative requirement to maintain assets against these liabilities (unlike pensions), the university funds them on a pay-as-you-go basis, similar to what other universities do. It has implemented several cost-containment measures to moderate the liabilities' growth and expects that increased discount rates would curb, or even reverse, the liabilities' growth.

Based on public disclosures, we do not believe that Western has any additional contingent liabilities that could materially affect our view of its credit profile.

## Liquidity

At fiscal year-end 2017, total cash and investments increased to C\$1.7 billion from C\$1.4 billion in 2016, equal to over 4x our pro forma debt estimate and more than 2x our measure of available resources, indicating very robust liquidity. Western's available resources (internally restricted net assets plus internally restricted endowments) had increased to C\$697 million from C\$603.5 million the year before. We believe that available resources will remain more than sufficient to finance all debt service requirements and provide a sufficient buffer for any likely medium-term stress scenario. In addition, strong market returns in fiscal 2017 helped to boost the market value of the university's endowment to almost C\$679 million from C\$580.6 million at the end of fiscal 2016.

## Moderately high likelihood of extraordinary provincial government support

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), and that there are no viable private alternatives. It also reflects our view of the university's solid reputation, which its niche and research profile reinforce. The province's oversight, program approval rights, and tuition regulation over Western suggest a strong link to it. Also supporting this view is that the province provides substantial operating grants, which account for about a quarter of the university's total revenue, and it appoints four of 28 board members.

The Ontario government achieved its target of returning to fiscal balance in its 2017-2018 budget. Although we believe that the province's overall support for universities will remain solid, we do not expect overall funding for the sector to increase materially in the medium term. Under the new grant funding formula, the provincial government is shifting focus toward measurable student outcomes and away from a more enrollment-based formula. It has committed to maintain stable the 2016-2017 funding level for all universities until 2019-2020. Moreover, in December 2016, the province announced it would extend its tuition framework for the next two years, maintaining the annual increases capped to an average of 3% for most undergraduate programs and 5% for professional and graduate programs.

## University of Western Ontario -- Financial Statistics

--Fiscal year ended April 30--

	2018	2017	2016	2015	2014	Medians for 'AA' U.S. public colleges and universities, 2016†
<b>Enrollment and demand</b>						
Headcount	32,519	31,922	31,062	31,305	31,081	MNR
Full-time equivalent	33,051	32,528	31,772	31,765	31,448	32,506
First year acceptance rate (%)	51.5	58.1	56.1	53.6	51.4	69.3

University of Western Ontario -- Financial Statistics (cont.)

	--Fiscal year ended April 30--					Medians for 'AA' U.S. public colleges and universities, 2016†
	2018	2017	2016	2015	2014	
First year matriculation rate (%)	20.2	20.0	20.8	21.8	21.4	MNR
Undergraduates as a % of total enrollment (%)	80.5	81.5	81.6	82.0	82.0	77.7
First year retention (%)	N.A.	N.A.	93.2	93.3	92.5	86.0
Graduation rates (six years) (%)*	N.A.	83.4	83.6	82.3	82.2	MNR
<b>Income statement</b>						
Adjusted operating revenue (C\$000s)	N.A.	1,204,786	1,198,232	1,109,031	1,098,666	MNR
Adjusted operating expense (C\$000s)	N.A.	1,120,003	1,081,586	1,061,661	1,044,229	MNR
Net adjusted operating income (C\$000s)	N.A.	84,783	116,646	47,370	54,437	MNR
Net adjusted operating margin (%)	N.A.	7.6	10.8	4.5	5.2	1.46
Provincial grants to revenue (%)§	N.A.	23.0	22.7	24.5	25.1	19.4
Student dependence (%)	N.A.	33.8	31.8	32.1	30.3	41.8
Investment income dependence (%)	N.A.	10.2	2.3	7.3	8.2	0.8
<b>Debt</b>						
Debt outstanding (C\$000s)	N.A.	288,042	294,057	303,576	310,290	698,540
Current debt service burden (%)	N.A.	1.83	1.99	2.32	1.85	MNR
Current MADS burden (%)	N.A.	3.09	3.59	3.42	2.88	3.60
<b>Financial resource ratios</b>						
Endowment market value (C\$000s)	N.A.	678,960	580,615	585,779	509,659	748,837
Cash and investments (C\$000s)	N.A.	1,661,799	1,416,635	1,372,329	1,199,212	MNR
Adjusted UFR (C\$000s)	N.A.	697,138	603,537	560,906	498,898	MNR
Cash and investments to operations (%)	N.A.	148.4	131.0	129.3	114.8	54.7
Cash and investments to debt (%)	N.A.	576.9	481.8	452.1	386.5	159.6
Adjusted UFR to operations (%)	N.A.	62.2	55.8	52.8	47.8	31.9
Adjusted UFR to debt (%)	N.A.	242.0	205.2	184.8	160.8	89.7
Average age of plant (years)	N.A.	15.0	14.4	13.5	12.6	12.9
OPEB liability to total liabilities (%)	N.A.	29.4	32.3	30.3	26.8	MNR

Note: Average age of plant equals accumulated depreciation divided by depreciation and amortization expense. \*Median figure is five-year graduation rate. §Median figure is state appropriations to revenue. †U.S. median figures are in U.S. dollars. MNR--Median not reported. MADS--Maximum annual debt service. UFR--Unrestricted financial resources. N.A.--Not available.

## 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

- Fiscal Median Ratios Of Public Universities In Australia, Canada, Mexico, And The U.K.: Operating Margins Remain Mostly Solid Despite Lower Government Transfers, July 27, 2017
- U.S. Public College And University Fiscal 2016 Median Ratios: Lower Rated Entities Pressured In An Otherwise Relatively Stable Sector, July 20, 2017

## Ratings List

Ratings Affirmed

University of Western Ontario

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](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on the S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.



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