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University of Guelph

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University of Guelph

Rationale

Issuer Credit Rating
A+/Stable/--

The ratings on the University of Guelph (UofG), in the Province of Ontario, reflect its stand-alone credit profile (SACP), which Standard & Poor's Ratings Services assesses at 'a+'. 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. The SACP on UofG reflects Standard & Poor's opinion of the university's good enrollment and demand profile, strong consolidated financial performance, and increasing endowment market value (and consequently unrestricted financial resources). In our opinion, substantial postemployment liabilities, an increasing debt burden, and the fiscal challenges facing the provincial government offset some of these strengths.

UofG is a medium-size university with comprehensive program offerings. Full-time equivalent student numbers (FTEs) on the main campus have declined slightly in the past two years and were down 0.1% in fall 2014 to 21,527, reflecting demographic shifts felt systemwide and the university's plans to essentially hold enrolment levels constant. However, overall we believe UofG continues to enjoy a good enrollment and demand profile. It has planned for fairly flat enrollment growth, reflecting the expected flattening of the university-aged population and the shift in demand from arts programs to engineering and other applied sciences as well as efforts by the university to contain increasing operating pressures. Demand remains strong, in our view. Applications were 2% higher in fall 2014 compared with the previous year, while the overall Ontario system average experienced a decline of 3%. Applications to the University of Guelph-Humber were up 19% and enrollment is now at targeted capacity at this campus.

We expect the university will maintain consolidated surpluses in the next two years, although slightly below current levels given the operating pressures it faces -- primarily a new tuition framework, lower government grants, and increasing salaries and benefits expenditures. UofG's consolidated financial performance has been fairly strong, in our view, and its total surplus has improved in the past three fiscal years (year ended April 30) to 10% of expenses in 2014 (all figures Standard & Poor's-adjusted). This was primarily the result of higher tuition revenues, exceptional investment returns that reduced postemployment costs significantly, and restructuring efforts to contain operating expenditures, particularly as related to employee salaries and benefit costs.

Similar to many Canadian universities, UofG faces significant postemployment liabilities, despite pension assets recording very positive investment returns. Based on the 2013 actuarial valuation, its defined benefit pension solvency deficit stood at C$370 million, for which the province granted it solvency relief until fiscal 2017, after which the university will have seven years to amortize the deficit. This will result in total pension contributions of about C$46 million in fiscal 2015, increasing to about C$80 million after fiscal 2018. The university has identified an annual funding gap of about C$30 million starting in fiscal 2019 and we expect that its addressing these payments will put significant strain on the operating budget, although this lies outside our two-year rating horizon.

UofG expects its debt burden to continue increasing, given its current capital plan and significant deferred maintenance backlog. Its debt reached C$235 million in fiscal 2014 and should increase to about C$285 million by fiscal 2017, mainly due to the completion of several major projects, including athletics facilities and a series of energy conservation investments. At this level, we estimate it could get close to 40% of adjusted revenues, a level that could put downward pressure on the ratings. Nevertheless, we believe that its debt service coverage ratio will remain adequate in the next two years, at more than 3.0x its adjusted net revenue available for debt service; it was 4.5x in fiscal 2014.

Although the Ontario government faces fiscal challenges and projects it will not return to fiscal balance until fiscal year 2017-2018, we do not expect provincial operating grants for postsecondary education to diminish significantly, given its vital public policy role.

In accordance with our criteria for government-related entities, we base our view of UofG's "moderately high" likelihood of "extraordinary" government support on 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. The assessment 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 UofG suggests a "strong" link to it. Also supporting this view is that the province provides substantial operating grants, which account for about a third of the university's total revenue (including grants received under the Ontario Ministry of Agricultural, Food and Rural Affairs), and it appointments some board members.

We have used the "Principles Of Credit Ratings," in conjunction with "USPF Criteria: Higher Education," as our criteria foundation for our analysis of UofG'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

UofG's liquidity is sound, in our view. At fiscal year-end 2014, its reported cash and investments totaled C$648 million, or 97% of adjusted total expenditures and 276% of debt. Unrestricted financial resources (consisting of internally restricted net assets and internally restricted endowments) at the end of 2014 were what we consider high, at C$382 million, or 57% of adjusted total expenditures and 163% of debt outstanding. Although we expect these ratios might fall in the next two years, we believe they will remain adequate to finance all debt service requirements and provide a sufficient buffer to withstand any likely medium-term stress scenario.

The market value of the university's endowment was C$309 million in April 2014, the highest level to date. Endowment per FTE also improved significantly, to C$14,344 from C$7,724 in 2009; we expect it will stay above C$10,000 in the next two years.

Outlook

The stable outlook reflects Standard & Poor's expectations that, within our two-year outlook horizon, UofG will maintain a good enrollment and demand profile; its consolidated financial performance will remain robust, with continued adjusted surpluses being generated; and its liquidity will remain strong. We could revise the outlook to negative or lower the ratings if operating deficits emerged as result of a significant reduction in government grants or substantial pressure from rising pension contributions; debt service coverage fell to less than 2x; or debt-to-adjusted revenues rose beyond 40%. Reduced unfunded postemployment liabilities or a more permanent pension solvency relief solution, or reduction in debt burden, and continued strong operating surpluses could result in an upward revision to the outlook or the ratings.

Rating Methodology: Government Support And Government-Related Entity Criteria

In accordance with our criteria for GREs, our view of UofG'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. The assessment 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 UofG suggests a strong link to it. Also supporting this view is that the province provides substantial operating grants, which account for about a third of the university's total revenue (including grants received under the agreement with OMAFRA), and it appointments some board members. Although Ontario is facing significant fiscal challenges and projects large provincial deficits in the medium term, we believe that postsecondary education will remain a top priority for the province and that overall support for the university sector will be fairly stable.

Enterprise Profile

Background

Founded in 1964, UofG consists of seven colleges whose undergraduate and graduate programs cover arts, biological science, business and economics, physical and engineering science, social and applied human sciences, the Ontario Agricultural College, and the Ontario Veterinary College. Total FTE enrollments stood at 21,527 in fall 2014 (for the main Guelph campus only), down 0.1% from the previous year. This reflected the decline in domestic applications systemwide and was generally in line with the university's enrollment plan. In fall 2002, the University of Guelph-Humber was created as a joint venture between UofG and Humber College. It has enjoyed strong demand, and headcount at this facility was almost 4,300 in fall 2014.

The university is among Canada's most research-intensive universities. In fiscal 2014, UofG received C$142 million in sponsored research funding, the lowest level in the past five years, reflecting the winding down of a major one-time OMAFRA grant received in 2008 the completion of a number of large federally-sponsored projects. A major component of the university's activity is its multifaceted agrifood research initiative that OMAFRA sponsors. In addition to accounting for about 37% (C$53 million in 2014) of UofG's research funding, the OMAFRA contract gives it a strong niche among Ontario's universities. In fiscal 2014, it supported 10% of all faculty positions (91), and 12% of total staff (397).

Management

UofG operates under a bicameral system of governance with a board of governors and a senate. The senate exercises general control and supervision over academic affairs, subject to the board's authority. The board consists of 24 members, four of which the province appoints. In August 2014, Franco Vaccarino became president. Mr. Vaccarino is a neuroscientist who was most recently the principal of the University of Toronto Scarborough campus. UofG is also looking to permanently fill three vice-president positions, including the provost. UofG prepares five-year plans for its operating and capital financing budgets and has financial policies in place, including investment and debt policies.

University demand and enrollment

We believe the university's credit profile benefits from healthy and stable demand and enrollment. Applications were 2% higher in fall 2014 compared with 2013, while the overall Ontario system experienced a decline of 3%. Applications to the University of Guelph-Humber were up 19%. Total headcount now stands at almost 23,000 on the main campus and 4,286 at Guelph-Humber. Most of the growth in FTEs is occurring at Guelph-Humber; however, Guelph-Humber is now operating at its planned capacity and has submitted a bid (led by Humber College) to the province to expand its facilities. The university reports some weakness in domestic undergraduate growth, particularly in art programs, but international student enrollment is increasing modestly and demand for engineering and other applied science programs are strong. UofG expects its enrollment and demand to remain relatively flat in the near term, in line with the province's assessment of relatively flat enrollment trends due to a slowdown in the university age population growth. However, through the University of Guelph-Humber, which is very close to the Greater Toronto Area (GTA), UofG could benefit from the stable demographic growth projected in GTA's university age population through 2022.

Student quality metrics also remain good, in our opinion. The acceptance rate (offers-to-applicants) increased to 65% in fall 2014, above the five-year average of 59% but in line with that of similarly rated peers. The matriculation rate remained adequate, in our view, at 31%, lower than the five-year average of 34% due to lower registrations in arts and science programs. The average entry grade, retention rate of first-year students and graduation rate (six-year) were all steady at 84%, 89%, and 79%, respectively.

Financial Profile

Government funding

Ontario monitors and guides tuition student aid (through the tuition framework) and enrollment expansion (through operating grants). However, universities have the final decision in these matters and their long-term strategy. In March 2013, the province implemented a four-year tuition framework, reducing the cap on annual increases to an average of 3% for undergraduate programs and 5% for professional and graduate programs in the next four years (from a maximum annual average of 8% institution-wide). Universities have some flexibility on how they increase tuition amongst programs as long as the total increase entity-wide is below the cap. The province has also made some changes which have affected the entire university sector, including reduced base operating grants and reduced grants based on enrollment of full-time international students and new requirements to meet efficiency targets.

In 2014, the provincial government required all universities to submit a strategic framework to guide and align the university's strategy and growth with provincial government objectives for higher education. UofG has completed this process.

The university's government grants for general operations (excluding the OMAFRA contract) was fairly stable at C$183 million and accounted for about 25% of its total revenues in fiscal 2014. We believe that Ministry of Training, Colleges, and Universities (MTCU) operating grant reductions announced as part of the province's 2012 budget could result in a modest reduction in operating revenue in the next several years, particularly if UofG is not able to attract more international students or students enrolled in disciplines with unregulated tuition to offset these reductions. In addition to base operating grants that are allocated per FTE, the university also has an agreement with OMAFRA, which it has extended through 2018. The total envelope it receives remains fairly stable, at about C$70 million annually.

Ontario has a history of providing strategic funding programs to address other operating and capital pressures. Because the government is projecting budget deficits until fiscal 2018 and economic growth forecasts remain modest, we believe that there will be little room for it to increase its support of universities and still meet this target. However, we do not expect provincial operating grants to diminish significantly, given postsecondary education's vital public policy role.

Operating performance

Since fiscal 2013, UofG has prepared its financial statements in accordance with the Canadian Institute of Chartered Accountants' new Not-for-Profit Accounting guidelines. These standards are accounted retrospectively, effective May 1, 2011. Under these accounting standards, the university will account for its future employee benefits obligations (pensions and other future employee benefits) using the immediate recognition approach. The impact involves the full recognition of the deficit in its pension plans and future employee benefits on the balance sheet, and the changes in the deficits directly in the net assets on the statement of financial position (which does not impact the statement of operations). UofG also elected to recognize its land at fair value, which increased its capital assets and internally restricted net assets at May 1, 2011, by C$245 million.

The university's consolidated financial performance has historically been strong, in our opinion. UofG has generated an adjusted consolidated surplus of 10.2% of adjusted expenditures in fiscal 2014, compared with 7.3% in 2013. We expect the university will maintain adjusted consolidated surpluses in the next two years, although slightly below 2014 levels given the operating pressures (lower government grants, increasing operating expenditures) it faces. Like its Canadian peers, UofG's salaries and benefits expenditures are a significant strain, typically accounting for more than 60% of its total reported expenditures. However, they actually declined 1.6% in 2014, largely reflecting lower research-related employee expenses and increases in pension assets.

The university's operating budgets for fiscal years 2015-2017 show a small operating deficit of C$2.6 million in fiscal 2015 (covered by one-time contingency funds) and balanced results in fiscal 2016 and 2017. Meeting these targets is predicated on the university achieving targeted budget reductions of C$9.4 million in fiscal 2015, increasing to C$18.7 million and C$25.4 million in fiscal 2016 and 2017, respectively.

Solvency relief moderates current pension contributions

UofG has several funded and unfunded defined benefits programs that provide pension and other postemployment benefits to its employees. As of its most recent actuarial valuation (Aug. 1, 2013), the university's pension deficit (professional and retirement plans) was C$370 million on a solvency basis and C$205 million on a going-concern basis. This compares negatively with the results of the previous actuarial valuation Aug. 1, 2010, and primarily reflects an increase in liabilities due to lower discount rates.

In fiscal 2014, under the new accounting standards, UofG's accrual pension plan's deficit was C$22 million, from C$11 million the previous year. The university also had a C$263 million nonpension postemployment deficit based on its fiscal 2014 audited statements. Because there is no legislative requirement to maintain assets against these liabilities (unlike pensions), UofG funds these pay-as-you-go, similar to other universities. However, combined pension and non-pension postemployment liabilities were 27% of total liabilities and 46% of adjusted expenses in 2014, from 41% in 2013. These ratios are high compared with that of similarly rated Canadian peers, some of whom have blended defined benefit or contribution plans, and annual plan expenses will continue to stress operating budgets.

In fiscal 2014, the pension fund's annual return (net of investment fees) was 17.0%, compared with 13.9% a year earlier. This was the highest annual return since 2006, bringing the total pension assets market value to C$1.2 billion and surpassing the peak from before the financial crisis.

UofG received approval for stage 2 of the province's solvency relief (which extends the amortization of solvency payment period to 10 years from five) after achieving the savings targets the province required. The 10-year amortization payment period associated with stage 2 relief will begin Aug. 1, 2014, with the first payment on Aug. 1, 2015. According to a new provincial legislation filed in November 2013, Ontario will allow universities to pay only the interest related to solvency pension payments in the first three years of stage 2 relief. This will result in total pension contributions of about C$46 million in fiscal 2015, and C$45 million in fiscal 2016 and 2017. After this time, contributions are expected to increase significantly to about C$80 million although the university has identified an annual funding gap of more than C$30 million after fiscal 2018, based on the current solvency amortization schedule.

Capital plan

In fiscal 2014, UofG's capital spending totaled C$49 million of which C$21 million was for equipment purchases and renovations, C$12 million was for student housing projects, C$7 million for deferred maintenance projects, and almost C$4 million to complete the expansion of the engineering school. Capital spending has been decreasing since 2011 and was significantly less than the C$68 million spent in 2013. The university reports that the cost to complete major projects in progress at the end of fiscal 2014 was C$35 million and UofG is not planning any major new projects in the next several years. Work has begun on the C$50 million renovation and expansion of the athletic center (to be completed in 2017). The university will finance capital costs with a student fee over 30 years. It financed its capital expenditures through a combination of external capital contributions, operating funds, and debt.

UofG estimates its deferred maintenance liability at C$300 million. In its five-year (2012-2016) capital financing plan, it evaluates that it requires C$15 million-C$20 million annually to contain the deferred maintenance backlog's progression. It receives about C$1 million annually from MTCU for repairs and renovations. However, most of the deferred maintenance financing is debt-related.

Debt burden

UofG's total gross debt outstanding stood at C$235 million in fiscal 2014, after it issued almost C$20 million. The debt consists of a C$100 million 40-year bullet debenture due 2042, C$3 million in mortgages and leases, and $132 million in amortizing banker's acceptances, which typically have a 10- or 15-year term and almost all of which mature in fiscal 2023 or later. According to its revised five-year capital plan, and subject to the board's approval, the university estimates that its total debt will reach about C$285 million in fiscal 2017.

UofG's debt service coverage ratio (as measured by Standard & Poor's-adjusted net revenues available for debt service to annual debt service costs) has improved the past two years and was 4.5x in fiscal 2014. While this ratio is in line with other rated Canadian universities, we believe that it could weaken in the next two years given the expected rise in debt levels and the tight operating environment. The university reported its debt per FTE at about C$10,900, slightly higher than in 2013 and somewhat larger than that of most of the other rated Canadian universities. We expect this to continue rising in the next few years because FTE growth should only be moderate. Debt-to-adjusted operating expenses also increased in the past five years, to 35% in 2014 from 30% in 2010, and we expect it will continue to increase further by 2017 because we estimate debt issuance will outpace revenue growth. Should the university's debt-to-adjusted expenses move above 40%, we believe stress on the ratings would likely result.

To repay its bullet debenture, UofG has a self-imposed sinking fund; its assets totaled C$11 million in fiscal 2014. The university has entered various interest-rate swap agreements with equally or higher-rated counterparties. These include Bank of Montreal, Toronto Dominion Bank, and Canadian Imperial Bank of Commerce. The swap agreements synthetically fix the university's variable-rate debt and are intended to be held to maturity.

Liquidity

Cash and investments increased significantly in fiscal 2014, to C$648 million from C$554 million in 2013. In our view, these strong balances were in line with similarly rated Canadian peers, at 97% of adjusted expenditures and 276% of debt outstanding. UofG also has an undrawn C$10 million line of credit. The university closed the fiscal year 2014 with C$382 million in unrestricted financial resources (which include internally restricted net assets and internally restricted endowments). This was materially better than 2013's C$230 million due to change in designation of the C$116 million Heritage Endowment Fund (HEF) from externally to internally restricted. The board of governors, with approval from the university's auditors, made the change to more accurately reflect the fact that there were never any external restrictions on the assets in this fund. Total unrestricted financial resources were equal to 57% of adjusted expenses and 163% of debt outstanding at the end of 2014. This represents a significant improvement from 34% and 102%, respectively, in 2013 and is now superior to that of similarly rated peers and previous years' levels.

Investments and endowment

Endowment assets improved considerably to a fair value of C$309 million, at April 30, 2014, from C$264 million a year earlier. This was primarily the result of exceptionally good investment returns in fiscal 2014. Reported endowment per FTE also strengthened significantly in 2014, reaching C$14,334 (compared with C$12,212 in 2013).

The university has a conservative endowment draw, in our view, with an annual spending rate of 3.5% of the rolling four-year average market value of the endowments in the general endowment fund (C$193 million at the end of fiscal 2014) and the average five-year net return, after incorporating inflation protection and growth of the portfolio, for the Heritage Endowment Fund (C$116 million). These funds benefit from a diversified asset allocation, in our opinion. The endowment's annual return (net of investment fees and expenditures) was 15.6% in fiscal 2014, which we consider strong.

Fundraising

UofG closed it most recent fundraising campaign in 2014 having raised C$203.6 million, greater than the C$200 million target. The majority of the raised funds will likely have external restrictions, which tends to be the case for about 90%

of the university's total endowment. However, we believe even these provide strength, by producing spendable endowment income. Furthermore, endowments restricted for scholarships or faculty chairs enhance a university's profile, attracting quality students and faculty. Although the university does not plan to launch any significant new campaign in the near term, it expects that annual cash donations will continue to be in the C$10 million-C$15 million range.

University of Guelph -- Peer Comparison						
	--University of Guelph--		--York University--		--McGill University--	
	2014	2013	2014	2013	2014	2013
Issuer credit rating as of year-end	A+/Stable/--	A+/Stable/--	AA-/Stable/--	AA-/Stable/--	AA-/Stable/--	AA-/Stable/--
Enrollment and demand						
Headcount	23,011	23,122	36,531	35,300	39,349	38,779
Full-time equivalent (FTE)	21,547	21,644	29,039	28,140	31,560	31,197
Acceptance rate (%)	59	55	83	76	45	43
Matriculation rate (%)	32	35	83	76	45	43
Undergraduate FTEs as % of total FTEs (%)	82	91	89	89	75	75
Income statement						
Adjusted operating revenues (C$000s)	736,783	715,498	1,016,874	983,060	1,166,470	1,141,043
Adjusted operating expenses (C$000s)	668,516	667,072	1,012,517	985,881	1,138,850	1,129,216
Estimated operating gain / loss as % of operating expenses (%)	10.2	7.3	0.4	(0.3)	2.4	1.0
Tuition and student fee dependence (% of adjusted revenues)	31.0	30.7	46.9	46.1	21.0	20.0
Debt						
Debt outstanding (C$000s)	235,000	225,156	405,211	305,881	193,020	199,683
Current debt service burden (% of adjusted expenses)	3.3	3.0	2.0	2.0	0.9	0.9
Financial resource ratios						
Total endowment (C$000s)	308,861	264,322	414,901	372,321	1,282,392	1,089,182
Cash and investments (C$000s)	647,614	554,468	836,990	677,589	1,376,609	1,172,379
Adjusted unrestricted financial resources (UFR; C$000s)	381,953	229,570	213,625	133,016	216,604	166,513
Cash and investments to adjusted expenses (%)	96.9	83.1	82.7	68.7	120.9	103.8
Cash and investments to debt (%)	275.6	246.3	206.6	221.5	713.2	587.1
Adjusted UFR to adjusted expenses (%)	57.1	34.4	21.1	13.5	19.0	14.7
Adjusted UFR to debt (%)	162.5	102.0	52.7	43.5	112.2	83.4
Unfunded pension and other postemployment liabilities to total liabilities (%)	26.9	24.8	8.5	23.8	8.2	9.1

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 Detail (As Of January 28, 2015)	
University of Guelph	
Issuer Credit Rating	A+/Stable/--
Senior Unsecured	A+
Issuer Credit Ratings History	
28-Nov-2008	A+/Stable/--
08-Nov-2007	A+/Negative/--
25-Oct-2006	A+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.