STANDARD & POOR'S

PUBLIC FINANCE

University of Guelph Ratings Lowered To 'A+' On Rapidly Rising Liabilities

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Rationale

On Oct. 25, 2006, Standard & Poor's Ratings Services lowered its long-term issuer credit and senior unsecured debt ratings on the University of Guelph to 'A+' from 'AA-'. The outlook is stable.

The ratings on the university reflect its rapidly rising unfunded post-employment liabilities that could require significant cash contributions to comply with regulatory solvency requirements; a continuously weak operating performance that we expect to persist; a debt burden that is likely to rise; and a large deferred capital maintenance that threatens the university's operations if not immediately addressed.

Offsetting these risks are Guelph's solid demand characteristics and its firm academic niche and research profile in agriculture, veterinary medicine, and science, which enhance the university's demand profile, attract research funding, and provide revenue diversity. The ratings are also underpinned by a slim but adequate debt service coverage ratio, as well as unrestricted financial resources that, although are not as strong as many of its peers, are rising.

Guelph's operating margin remained at a near break-even position at April 30, 2006. Such a weak operating position is not consistent with a 'AA-' rated entity, contributing to the downgrade. In Standard & Poor's update published Nov. 21, 2005, we stated our expectation that Guelph would improve its operating position. In addition to posting the lowest operating position of its rated Canadian peers, the university's operating margin has been in a near break-even position since about 2003. When Guelph was initially rated on Sept. 24, 2002, its operating margin, based on its fiscal year-end 2001 results, was about 7.1%. Several significant operating pressures suggest that Guelph's weak operating position could continue. The university has accepted about 800 more students than targeted and is not certain to what extent, if any, the Province of Ontario (AA/Stable/A-1+) will fund these students. Also, although the province has committed to funding universities to expand graduate enrolment, Guelph expects to face additional pressures from supporting these additional expected graduate students.

Other operating pressures facing the university in the next couple of years include hiring additional faculty to lower Guelph's student-faculty ratio; and raising student financial assistance to coincide with rising tuition. There have also been shifts in the programs that students demand in recent years, resulting in added pressures on the university's already overstretched resources.

Another operating pressure stems from Guelph's rising post-employment liabilities, which could require cash contributions of up to C$40 million in each of the next two years. As at year-end fiscal 2006, Guelph's unfunded pension liability was C$148.5 million, a 43% increase from fiscal 2005. Guelph's pension liability is substantially higher compared with fiscal 2002, when it had a C$42 million surplus. The swing to a deficit position largely stemmed from a lower discount rate used to value its pension obligation, with weaker equity returns also contributing.

Guelph also had about C$181.8 million in unfunded other post-employment benefit (health care and dental) liabilities at fiscal year end 2006. These liabilities are up sharply from 2002.

The downgrade on the university was largely spurred by the rapid current and expected increase in Guelph's liabilities. Although Guelph's unrestricted financial resources are up since fiscal 2005, its liabilities have risen more significantly and rapidly. In our Nov. 21, 2005, research update, we stated that any further worsening of Guelph's unfunded post-employment liabilities without increases in offsetting asset plans would place downward pressure on the ratings.

Guelph also has critical deferred capital maintenance needs. The university estimates them to be at C$300 million, which is exceptionally high relative to that of its peers and for an institution of its size. Guelph's management team is of the opinion that any further delay of the required capital maintenance could threaten the university's operation. Guelph's board has therefore approved borrowing of up to C$90.8 million to help fund C$121 million in critical capital maintenance requirements and capacity expansion. This would bring Guelph's pro forma debt to C$249.4 million, or C$13,856 on a full-time equivalent (FTE) basis. Guelph's interest expense to adjusted revenue would rise to about 3%. Both these measures would be higher than those of Guelph's Canadian rated peers.

Standard & Poor's believes that the medium- to long-term profile of the university remains solid. As the most recent application statistics illustrate, the university has exceptionally strong demand metrics. In addition to the university's strong, well-defined niche in the in agriculture studies, Standard & Poor's recognizes the province's vested interest in the successful operation of the university, not only in its role as a reputable postsecondary institution, helping advance government initiatives to promote a knowledge-based economy, at both the provincial and federal levels, but also in its critical role to Ontario's Ministry of Agriculture, Farming and Rural Affairs. Standard & Poor's also notes the university's impressive progress with its unrestricted financial resources, almost doubling the value on a per FTE basis since fiscal year end 2004.

Outlook

The stable outlook underpins Standard & Poor's belief that the solid track record of Guelph's prudent management team should revitalize and maintain the capital foundations, which will enable the successful long-term operation of the university. At the same time, we expect the university to cautiously and conservatively manage, and minimize whenever possible, the university's external financing needs. The outlook also reflects the expectation that Guelph will not increase its debt significantly further than expected. Further rapid and significant increases in Guelph's debt or unfunded post-employment liabilities could exert further downward pressure on the ratings. The ratings could be raised after a significant and sustained improvement in Guelph's operating position, the university bringing its pro forma debt to a level significantly lower than expected, or a significant drop in its unfunded post-employment liabilities and its related cash contributions.

Ratings List

University of Guelph

Ratings Lowered

	To	From
Issuer credit rating	A+/Stable/—	AA-/Stable/—
Senior unsecured		
Local currency	A+	AA-

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