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Research Update:

University of Western Ontario Ratings Affirmed At 'AA'; Outlook Is Stable

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Overview

- The University of Western Ontario has achieved strong operating margins again, which supports the university's financial resources and our assessment of its financial profile.
- At this time, we do not anticipate the recently announced cuts to tuition fees will affect our assessment of Western's financial profile.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on the university.
- The ratings reflect, in part, Western'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 Western will maintain a healthy market position and demand profile, and available resources will remain superior despite upcoming cuts to tuition fees.

Rating Action

On Feb. 13, 2019, 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 excellent net operating margins, high levels of unrestricted financial resources and a healthy enrollment and demand profile over the next two years. 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, net operating margins unexpectedly declined to balance or slight deficits on average and eroded unrestricted financial assets. Lower financial assets would likely cause debt service and debt coverage ratios to decline. This combination of events would strain Western's financial profile and could lead to a negative rating action. Furthermore, evidence of negative government intervention, 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 on the university, potentially to on par with or below those on the province, depending on the severity.

Upside scenario

An improvement in Western's already healthy enterprise profile could lead to a positive rating action. Specifically, 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 full-time equivalents (FTEs), could lead to a positive rating action in the next two years.

Rationale

The ratings on Western reflect the university's stand-alone credit profile, which S&P Global Ratings assesses at 'aa' based on very strong enterprise and financial profiles. Over the past 20 years, Western has remained committed to improving student quality metrics, which have translated into superior average entering grades and remarkable graduation and retention rates. Our assessment of the university's 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 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 challenging operating environment with newly mandated tuition cuts, relatively limited geographic student draw, and its moderate debt burden offset these strengths somewhat.

Founded in 1878, Western is a research-intensive, doctoral university. It is in the southwestern Ontario city of London, which has a population of about 384,000. Western has about 33,350 FTE students on its main campus. 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.

Western's very strong enterprise profile supports the credit profile assessment. Supporting this is our view of the higher education sector's low industry risk, with counter-cyclicality 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 to be about US\$50,000 in 2018; 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. The university says it would like to increase its international student body, which could support revenue diversity.

We believe the 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. The university 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 2018, it received C\$257 million in research-related grants and contracts, which have been slowly increasing in the past several years. Western has exceeded its C\$750 million fundraising goal under its Be Exceptional 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 that 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 has formal policies for endowments, investments, debt, and reserves.

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 11.5% in the past three fiscal years because enrollment growth has been stronger than the university had forecast, resulting in higher tuition revenue. Western, along with other Ontario universities, will face increased budget pressure from the government's requirement to cut domestic tuition fees by 10% in fiscal 2020 and freeze it the following year. The university's budget for fiscal 2020 is not yet available, but given Western's strong balances and the possibility of expenditure control and enrollment growth, we believe the university will be able to accommodate these cuts without falling into a deficit position.

In our view, the university has a relatively moderate debt burden. At fiscal year-end 2018, its total gross debt outstanding stood at C\$376.6 million. The debt consists of C\$2.2 million in bank debt; a fixed-rate, C\$189.2 million, 40-year bullet debenture due 2047; a fixed rate, C\$99.4 million, 40-year bullet debenture due 2057; C\$6.7 million in mortgages; C\$10.8 million related to Western's research park; and C\$68.3 million in amortizing banker's acceptances (from a C\$100 million nonrevolving facility maturing in fiscal 2027). We view Western's debt structure as aggressive because 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 has set aside C\$30.5 million in an internal sinking fund. Our estimate of maximum annual debt service (which includes an estimated principal component for non-amortizing debt) equals 3.9% of adjusted fiscal 2018 expenses. In our view, the

university's debt burden is manageable, given Western's good operating performance and the healthy level of available resources equal to 2.2x debt based on a three-year weighted average. The university does not expect 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 rated Canadian 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 with 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\$1.02 million at year-end 2017, and we do not consider the liabilities associated with this plan significant. The majority of Western's postemployment liabilities relate to unfunded nonpension benefits, such as medical and dental. At fiscal year-end 2018, these liabilities amounted to C\$495.3 million, up 4.6% from the previous year.

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 2018, total cash and investments increased to C\$1.9 billion from C\$1.7 billion in 2017, equal to over 5x our debt estimate and more than 2x our measure of available resources, and indicating very robust liquidity. Western's available resources (internally restricted net assets plus internally restricted endowments) had increased to C\$782 million from C\$697 million the year before. We believe that available resources will remain more than sufficient to finance all debt service requirements and sufficiently buffer any likely medium-term stress scenario.

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 the university's 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), despite recent changes to university funding. Moreover, our assessment of Western's important role recognizes the absence of viable private alternatives. It also reflects our view of the university's solid reputation. The province's oversight, program approval rights, and tuition regulation over Western suggest a strong link to the government. 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 26 board members.

We rate Western two notches above Ontario. The differential reflects our view that there is a measureable likelihood that the university's substantial

financial resources would meet ongoing operational and debt service requirements should the government default and temporarily suspend payments to Western. In addition, the differential reflects our belief that the university operates independently of the Ontario government as an autonomous legal entity with ownership of its assets. The board is responsible for the management, administration, and control of Western's property and other assets and all business affairs. We consider the risk of extraordinary negative government intervention low, given the university's operational independence, important public policy role, and the government's hands-off approach to the sector.

Ontario elected a new provincial government in June 2018. In January 2019, the government announced changes to university funding, which included a plan to cut domestic tuition fees by 10% for the 2019-2020 fiscal year, a freeze in tuition rates for the following fiscal year, and changes to its student assistance program and some student fees. Furthermore, the province has stated that there will be no additional grant revenue to offset the tuition cut. Of the changes, we expect cuts to tuition will have the largest impact on Western's finances. The university must comply or risk losing some of its core operating grants from the province. We expect Western will mitigate the loss in tuition revenue through increases in international enrollment and expense control and ultimately maintain a positive net operating margin. While the requirement to cut tuition fees was unexpected, it does not change our assessment of the government's likelihood of support based on Western's strong link and important role with the province.

University of Western Ontario -- Enterprise And Financial Statistics						
	--Fiscal year ended April 30--					--Medians for 'AA' rated public colleges and universities--
	2019	2018	2017	2016	2015	2017
Enrollment and demand						
Headcount	32,739	32,519	31,922	31,062	31,305	MNR
Full-time equivalent	33,353	33,059	32,528	31,772	31,765	34,653
Freshman acceptance rate (%)	54.9	51.5	58.1	56.1	53.6	66.0
Freshman matriculation rate (%)	18.6	20.2	20.0	20.8	21.8	MNR
Undergraduates as a % of total enrollment (%)	80.5	80.5	81.5	81.6	82.0	79.2
Freshman retention (%)	N.A.	93.4	93.1	93.2	93.3	86.0
Graduation rates (six years) (%)	83.4	83.2	83.4	83.6	82.3	MNR
Income statement						
Adjusted operating revenue (\$000s)	N.A.	1,259,352	1,169,093	1,170,496	1,085,810	MNR
Adjusted operating expense (\$000s)	N.A.	1,100,306	1,084,310	1,053,850	1,038,440	MNR
Net adjusted operating income (\$000s)	N.A.	159,046	84,783	116,646	47,370	MNR
Net adjusted operating margin (%)	N.A.	14.5	7.8	11.1	4.6	1.22
Provincial grants to revenue (%)	N.A.	22.3	23.7	23.2	25	19.5

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

	--Fiscal year ended April 30--					--Medians for 'AA' rated public colleges and universities--
	2019	2018	2017	2016	2015	2017
Student dependence (%)	N.A.	34.6	34.9	32.5	32.8	42.4
Investment income dependence (%)	N.A.	6.3	10.5	2.4	7.4	1.4
Debt						
Outstanding debt (\$000s)	N.A.	376,576	288,042	294,057	303,576	798,089
Current debt service burden (%)	N.A.	2.05	1.89	2.04	2.37	MNR
Current MADS burden (%)	N.A.	3.88	3.19	3.69	3.49	3.51
Financial resource ratios						
Endowment market value (\$000s)	N.A.	746,466	678,960	580,615	585,779	858,805
Cash and investments (\$000s)	N.A.	1,933,753	1,661,799	1,416,635	1,372,329	MNR
Adjusted UNA (\$000s)	N.A.	782,486	697,138	603,537	560,906	MNR
Cash and investments to operations (%)	N.A.	175.7	153.3	134.5	132.2	58.2
Cash and investments to debt (%)	N.A.	513.5	576.9	481.8	452.1	167.8
Adjusted UNA to operations (%)	N.A.	71.1	64.3	57.3	54.0	34.3
Adjusted UNA plus debt service reserve to debt (%)	N.A.	207.8	242.0	205.2	184.8	100.5
Average age of plant (years)	N.A.	16.0	15.1	14.5	13.6	13.1
OPEB liability to total liabilities (%)	N.A.	28.6	29.4	32.3	30.3	MNR

N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service. Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expenses.

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

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

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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.

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