

University of Western Ontario

February 21, 2023

This report does not constitute a rating action.

Credit Highlights

Overview

Enterprise profile

--The University of Western Ontario's solid market position and outstanding student quality metrics underpin its very strong enterprise profile.

--The excellent economic and demographic fundamentals of the Province of Ontario help to sustain domestic demand.

--However, as Western attracts most of its students from Ontario, it has a more limited geographic draw relative to Canadian peers.

Financial profile

--We expect that spurred by the persistent enrollment growth, the university will continue generating very strong operating margins.

--We expect the university's significant financial resources will help to keep its debt burden moderate.

--Western's credit profile is bolstered by strong liquidity.

PRIMARY CONTACT

Elisa Lopez cortes
Toronto
1-416-507-2574
elisa.lopez.cortes
@spglobal.com

SECONDARY CONTACT

Adam J Gillespie
Toronto
1-416-507-2565
adam.gillespie
@spglobal.com

RESEARCH CONTRIBUTOR

Deepanshu Goyal
CRISIL Global Analytical Center,
an S&P Global Ratings affiliate
Gurgaon Haryana

S&P Global Ratings' long-term issuer credit rating on the University of Western Ontario is 'AA'. The rating reflects Western's 'aa' stand-alone credit profile, which is based on our combined assessment of the university's very strong enterprise and financial profiles. The rating also reflects our opinion of a moderately high likelihood that the Ontario government would provide extraordinary support in the event of financial distress. Western continues to generate very strong financial results despite the operational disruptions to on-campus activities, with healthy student demand helping to offset losses in ancillary operations and flat government funding and domestic tuition revenue. We believe that the threat of a prolonged COVID-19 pandemic and associated restrictions to on-campus activities have largely abated.

Outlook

The stable outlook reflects our expectation that, in the next two years, Western will be able to manage its budgetary pressures to generate strong operating margins greater than 5% of adjusted operating expenses on average, its levels of available resources will remain high, and it will maintain a strong enrollment and demand profile. The outlook also reflects our expectation that the university's relationship with the province will be stable.

Downside scenario

We could lower the ratings in the next two years if enrollment levels and revenue materially decreased, resulting in significantly weaker financial performance and available resources. 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 very strong enterprise profile could lead to a positive rating action. Specifically, a selectivity ratio consistently below 50% or 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

Founded in 1878 and located in London, Ont., the University of Western Ontario is a research-intensive, doctoral university with 12 faculties and schools, including schools of medicine and dentistry, law, engineering, and business. It is a founding member of the U15, Canada's most distinguished research universities. As of fall 2022, the university had 38,060 FTE students, a 3.1% increase from the previous year. It also has affiliations with four research institutes, three university colleges, and two teaching hospitals.

Western's very strong enterprise profile is characterized by a strong demand profile and market position, as well as good management and governance practices. In fall 2022, the first-year selectivity rate (offers-to-applications) was 67.1% and it has been increasing since 2021; however, this is in line with that of Canadian peers, which all increased domestic offers in anticipation of a drop in international student enrollment. In fall 2022, Western's total headcount rose 2.5%, accompanied by an uptick in undergraduate student numbers of 3.5%, which helped to offset the slight decline in graduate student numbers. Meanwhile, the percentage of international students had modestly increased, highlighting that the proportion of students from Ontario is 79%. Therefore, we view Western's student draw as having limited geographic diversity compared with that of some peers. The university continues working toward increasing its international student body and expanding its source countries, which could support revenue diversity. Western has consistently demonstrated strong retention rates greater than 90% and six-year graduation rates averaging 84% in the past four years. Also supporting our assessment is our view of the higher education sector's low industry risk, with countercyclicality and low competitive risk and growth. In addition, the university benefits from excellent economic fundamentals, as measured by the province's GDP per capita, which we estimate to be about US\$54,000 in 2022; good income indicators; and moderate employment and population growth projections.

In our view, the university's senior administration has sufficient depth and expertise and has demonstrated consistent operational effectiveness, as evidenced by a track record of strong operating margins that we believe lends stability to the credit profile. Overall, we consider Western's transparency and disclosure good, with policies, procedures, and risk management capabilities to adequately identify, monitor, and mitigate risks. The university typically 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 and has formal policies for endowments, investments, debt, and reserves.

We assess Western's financial profile as very strong, supported by robust operating margins of almost 18% on a three-year weighted-average basis. The university ended fiscal 2022 with a high net operating margin of 22% (S&P Global Ratings adjusted), reflecting the significant increase in sales and services (ancillary operations revenues) due to more on-campus activities. Similar to that of Canadian peers, the university's limited flexibility to increase its student-generated revenue somewhat offsets its strong financial performance. This is primarily because Ontario monitors and guides domestic tuition rates, student aid (through the tuition framework), and enrollment expansion (through operating grants, which are not expected to increase in real terms).

As of 2022, Western had C\$2.9 billion in cash and investments, a slight increase from C\$2.7 billion in 2021, more than two times its available resources, indicating very strong liquidity, which bolsters our assessment of the financial resources potentially available to it under a stress scenario. Our measure of available resources (internally restricted net assets plus internally restricted endowments) slightly increased to C\$1.3 billion at year-end fiscal 2022 from C\$1.2 billion the year before. This was sufficient to cover 107% of adjusted operating expenses on a three-year weighted-average basis, a level we consider very high. We expect Western's liquidity will remain more than sufficient to fund all debt service requirements and provide a significant buffer against medium-term stress.

Western has the eighth-largest endowment among Canadian universities. The endowment market value increased slightly to C\$1.0 billion at fiscal year-end 2022 from C\$990 million in 2021, reflecting good investment management of the endowment portfolio. Approximately C\$36 million of endowed investment returns was allocated for spending in fiscal 2022, in line with the university's spending policy of 4% of the average value of the total endowment over the most recent five-year period.

In our view, the university has a moderate debt burden. At fiscal year-end 2022, total gross debt outstanding was C\$327.4 million and consisted of two 40-year fixed-rate bullet debentures totaling C\$288.7 million (maturing in 2047 and 2057) and C\$39 million in amortizing banker's acceptances (from a C\$100 million nonrevolving facility maturing in fiscal 2027). In our view, the debt structure is aggressive, because more than 50% of total debt is non-amortizing; however, the university has established sinking funds to help repay the bullet debentures (C\$41.5 million at the end of fiscal 2022), partially mitigating the associated risks. Our estimate of maximum annual debt service (which includes an estimated principal component for non-amortizing debt) equals 2.6% of adjusted fiscal 2022 operating expenses. In our view, the debt burden is manageable, given Western's good operating performance and the healthy level of available resources equal to more 3x the debt, based on a three-year weighted average. The university does not expect to take on additional external debt in the next few years and we believe that debt service coverage will remain more than adequate throughout our outlook horizon.

Western has a defined-contribution pension plan for current employees, shifting 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\$228,000 as of December 2021. We do not consider the liabilities associated with this plan significant. Most of Western's postemployment liabilities relate to unfunded non-pension benefits, such as medical and dental. At fiscal year-end 2021, these liabilities amounted to C\$478.6 million, 15% less than 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.

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 the university's size, strong reputation, and research capabilities, which would make it hard to replace. 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 five-year average of 20% of the university's total revenue, and it appoints four of 28 board members.

We rate Western two notches above Ontario. The differential reflects our view that there is a measurable 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 to be low, given the university's operational independence, important public policy role, and the government's hands-off approach to the sector.

In January 2019, the government of Ontario imposed a 10% reduction to domestic tuition for the 2019-2020 academic year and a freeze through 2022-2023. Furthermore, the province did not provide additional grant revenue to offset the tuition cut and is at present targeting the implementation of performance-based funding in fiscal 2024. Neither the federal nor provincial government has announced any material financial support to the postsecondary sector. Although we are not expecting any material increase in ongoing operating or capital funding from the province in the medium term, we still believe that there is a moderately high likelihood that the province would provide support to Western in a distress scenario.

Environmental, Social, And Governance

We view the health and safety social risks posed by the pandemic as abating for the higher education sector; however, given the pandemic's significant effects on modes of instruction and enrollment trends over the past two years, we believe a future public health event of similar size and scope could again affect demand and finances. We evaluated Western's environmental and governance factors and found them to be neutral within our credit analysis sector as a whole.

Key Statistics

University of Western Ontario – Selected Indicators

(Mil. C\$)	--Fiscal year-end April 30--					Medians for 'A' rated public colleges & universities*
	2023 demand	2022	2021	2020	2019	2021
Enterprise profile						
Full-time equivalent enrollment (no.)	38,060	36,904	35,258	33,737	33,353	37,225
Selectivity rate (%)	67	64	66	53	55	71
Undergraduates as a % of total enrollment	81	80	81	80	81	81
Retention rate (%)	N.A.	N.A.	93	95	94	86
Graduation rates (six years) (%)	N.A.	85	85	83	83	70
Financial profile						
Adjusted operating revenue	N.A.	1,445	1,280	1,290	1,306	MNR
Adjusted operating expense	N.A.	1,184	1,106	1,161	1,146	MNR
Net adjusted operating margin (%)†	N.A.	22	16	11	14	4

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Student dependence (%)	N.A.	34	36	35	35	36
Government operating grant dependence (%)	N.A.	19	21	21	20	17
Investment income dependence (%)	N.A.	8	18	3	7	1
Outstanding debt	N.A.	327	345	353	361	862
Maximum annual debt service/total operating expense (%)	N.A.	3	4	4	4	3
Available resources to adjusted operating expenses (%)	N.A.	113	111	83	79	43
Available resources to total debt (%)†	N.A.	409	357	275	252	132

*U.S. median figures are in U.S. dollars. †As % of adjusted operating expense. N.A.--Not available. MNR--Median not reported.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Outlook For Global Not-For-Profit Higher Education: Credit Quality Continues To Diverge, January 18, 2023
- Australia, Canada, Mexico, And U.K. Universities Medians: Fiscal 2021 Credit Trends Turned Positive Despite Challenges, Oct. 20, 2022
- U.S. Not-For-Profit Public College And University Fiscal 2021 Median Ratios: Federal and State Funds Relieve Pandemic Pressure, Elevate Margins, July 12, 2022

Ratings Detail (as of February 21, 2023)*

University of Western Ontario

Issuer Credit Rating	AA/Stable/--
Senior Unsecured	AA

Issuer Credit Ratings History

26-Feb-2013	AA/Stable/--
14-Dec-2010	AA/Negative/--
04-May-2007	AA/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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