

Research Update:

University of Western Ontario Outlook Revised To Positive On Stable Enrollment And Strong Financial Results

February 21, 2024

Overview

- We expect operating margins will weaken modestly but remain healthy despite higher employee-related costs, faculty expansion, and limited growth in provincial grants.
- The University of Western Ontario's (Western) consistent enrollment growth, coupled with a recovery in ancillary operations, will contribute to robust financial performance.
- As a result, S&P Global Ratings revised the outlook to positive from stable and affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on the University of Western Ontario.
- The positive outlook reflects our expectation that Western will maintain its market position and strong credit metrics despite the uncertainties surrounding provincial funding and tuition policies, and a temporary federal cap on international student permits.

Rating Action

On Feb. 21, 2024, S&P Global Ratings revised the outlook on the University of Western Ontario, in the Province of Ontario, to positive from stable. At the same time, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings.

Outlook

The positive outlook reflects the likelihood that Western will sustain strong financial performance through stable full-time equivalent (FTE) enrollment and strong liquidity, ensuring a manageable debt burden.

Downside scenario

We could revise the outlook to stable if, in the next two years, through a combination of sector

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challenges and capital requirements, Western experiences a sustained weakening in operating performance and its debt burden increases such that cash and investments are no longer sufficient to cover more than 6x debt outstanding. Although unlikely, a strengthening of our assessment of the link between Western and the province could lead to the equalization of our ratings with those on Ontario.

Upside scenario

We could raise the ratings in the next 24 months if the university maintains healthy operating margins and a strong demand profile as we gain more clarity on the tuition and operating grant framework in the Province of Ontario, and the impact of the temporary federal cap on international student permits on operations. We would also expect maximum annual debt service to remain below 4% of operating expenses. In addition, we expect no change to our assessment of the university's role and link to the province.

Rationale

Western's 'aa' stand-alone credit profile (SACP) reflects the university's very strong enterprise and financial risk profiles.

Similar to other rated universities in Ontario, Western faces operational challenges such as constrained domestic tuition fees and operating grants, as well as inflationary cost pressures that we expect will affect operating margins in the next few years. Our financial performance forecast over the next two years is tempered by our expectation that growth in operating expenses will outpace revenue growth, compounded by constrained provincial grants and no change in domestic tuition fees. Despite these issues, we expect Western will maintain healthy operating margins above 7% through the outlook horizon, although we believe they will decrease as costs accelerate. Furthermore, Western has exceptionally strong liquidity and a moderate debt burden.

The university is strategically positioned to accommodate growth and navigate obstacles.

We believe Western has a very strong enterprise profile. Supporting our opinion is our assessment of the higher education sector, which is marked by low industry risk due to high barriers to entry and its typically countercyclical nature, making it more resilient during downturns compared with other sectors. In addition, the university benefits from excellent economic fundamentals in its main service area, Ontario, the most populous province in Canada, with high GDP per capita, estimated at almost US\$55,400 in 2024.

The Canadian government recently announced a temporary two-year cap on processing new student visa applications starting in fall 2024, projecting a 35% reduction in approved study permits compared with 2023. Provinces will be allocated a portion of the cap based on their population but Ontario has not yet articulated how its allocation will be distributed among its designated learning institutions.

We expect that Ontario, which already had a disproportionately large number of foreign students, will face a significant reduction in incoming international students, although the cap will not apply to current permit holders, or masters and doctoral applicants. While we believe that Western will see a moderate decline in higher-fee-paying international students in the next several years, we note that it is relatively less exposed than some domestic peers, with international

undergraduates accounting for only 9% of total fall 2023 FTEs. In addition, Ontario will require its post-secondary institutions to guarantee housing options are available for incoming international student cohorts. Western, equipped with a first-year housing guarantee, supported by 11 existing residences, and with two more proposed, is well positioned to meet this requirement.

In fall 2023, Western saw its total FTE enrollment increase by 3.7%, aligning closely with its five-year average of 3.4%. International students represent about 13% of total FTEs, slightly lower than similarly rated peers in Canada but increasing this proportion remains a strategic goal of the university. In our opinion, student quality at Western remains high, and we expect it to maintain excellent student quality characteristics. Western and Brescia University College, an affiliated institution and the only university-level women's college in Canada, recently agreed to a plan that would see Western absorb Brescia's operations and approximately 1,100 FTEs in the upcoming fall. We forecast that total FTEs will reach about 42,000 by fiscal 2026 (year ending April 30).

In our view, Western exhibits very strong management and governance practices that align well with those of other rated Canadian universities. We consider Western's transparency and disclosure good, with policies, procedures, and risk management capabilities to adequately identify, monitor, and mitigate risks. The senior administration's operational effectiveness is evidenced by a track record of strong operating margins supporting the stable credit profile.

Founded in 1878 and located in London, Ont., Western 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. It also has affiliations with four research institutes and two university colleges (down from three before Brescia's integration), as well as two teaching hospitals.

Strong enrollment demand will continue to support operations.

Western's financial profile is very strong, in our view, supported by healthy adjusted operating margins averaging about 11% over five years, including the outlook horizon years, which is above medians for 'AA' rated public colleges and universities.

The Ontario government has announced that it intends to repeal its 2019 Bill 124, which capped annual wage increases for public sector employees, including university faculty, at 1% for three years, after the Court of Appeal ruled it was unconstitutional. As a result, we anticipate an upward adjustment in employee-related costs, surpassing the budgeted figures in fiscal 2024 and reflecting a faster-than-expected growth trend.

The government is reviewing recommendations from a commissioned report on the financial sustainability of Ontario's postsecondary sector. Key proposals include raising base per-student funding and adjusting domestic tuition, which has been frozen since the province implemented a 10% reduction in fiscal 2020. We have not incorporated any tuition increase into our current base-case scenario. Student fees, including tuition, contribute approximately 35% of Western's total adjusted operating revenues.

In our view, Western, like other Canadian universities, has limited flexibility to increase student-generated revenue. This is primarily because the province monitors and guides domestic tuition rates through the tuition framework, and enrollment expansion through operating grants, which have not increased in real terms in recent years.

We view Western's liquidity as a key credit strength. At the end of fiscal 2023, Western held C\$3.0 billion in cash and investments, a slight increase from C\$2.9 billion in the previous year. We project that this liquidity will be sufficient to cover more than 2x its operating expenses in the next two years, which we see as extremely strong. As of fiscal year-end 2023, approximately 28% of

total cash and investments is linked to externally restricted endowments.

Western has the eighth-largest endowment among Canadian universities. The endowment market value increased slightly to C\$1.14 billion at the end of fiscal 2023, from C\$1.04 billion in the previous year. The university has a spending policy of 4% of the average value of the total endowment over the most recent five-year period.

Western is executing multiple capital projects on its campus. A significant one, the construction of the Ronald D. Schmeichel Building, is expected to finish later this year, while the second phase of the modernization of the Weldon Library is underway. These projects are financed through a combination of the proceeds of previously issued debentures, reserves, and grants. Additional plans include the construction of two new residences, supplementing the existing 11 campus residences, as well as a new engineering building and a new community hub.

In our view, Western has a moderate debt burden compared with those of other rated Canadian institutions, with about C\$319.3 million of total debt outstanding at the end of fiscal 2023. This comprises two 40-year fixed-rate bullet debentures, amounting to C\$288.7 million (maturing in 2047 and 2057), and C\$30.6 million in amortizing banker's acceptances sourced from a C\$100 million nonrevolving facility maturing in fiscal 2027. We believe the refinancing risks associated with the bullet debenture are partially mitigated by the time until maturity and the voluntary sinking fund, exceeding C\$42.9 million as of fiscal 2023 year-end. In fiscal 2025, Western will take on Brescia's debt, amounting to approximately C\$35 million, which it intends to extinguish with funds on hand. The university does not expect to take on additional external debt in the near term and we believe that debt service coverage will remain more than adequate throughout our outlook horizon. We estimate that the university's maximum annual debt service will remain stable at 2.3% of adjusted expenses by the end of fiscal 2026, down from 2.4% in fiscal 2023. We consider Western's debt burden to be manageable, given its strong operating performance, and we project that total cash and investments will continue to exceed 9x debt outstanding.

Western has a defined-contribution pension plan for current employees, effectively transferring investment risks away from the institution. This compares with certain institutions that might encounter obligations for special solvency payments to address pension plan deficits. Most of Western's postemployment liabilities relate to unfunded non-pension benefits, such as medical and dental. As of fiscal year-end 2023, these liabilities totaled C\$420.7 million, a 12% reduction from the previous year.

We have not identified any additional contingent liabilities that could materially affect our assessment of Western's credit profile.

Moderately high likelihood of extraordinary provincial government support

The ratings reflect Western's SACP and our belief that there is a moderately high likelihood that the government of Ontario would provide extraordinary support to Western in the event of financial distress. The impact of this potential support on the ratings is considered neutral. This view reflects our assessment of the university's important role in the province, given that postsecondary education is one of Ontario's priorities in both spending and mandate (after health care and school boards). Moreover, our assessment of Western's important role recognizes the absence of viable private alternatives. The university's substantial size, distinguished reputation, and robust research capabilities make it difficult 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 financial resources would be sufficient to sustain ongoing operational and debt service obligations even in the event of a government default or temporary suspension of payments. In addition, the differential reflects our belief that Western operates independently of the Ontario government as an autonomous legal entity with ownership of its assets. We consider the risk of extraordinary negative government intervention low, given the university's operational independence, important public policy role, and the government's largely noninterventionist stance toward the sector.

Environmental, social, and governance

We analyzed Western's risks related to environmental, social, and governance factors and determined them to be neutral in our overall credit analysis as a whole. Although health and safety social risks associated with the pandemic have abated for the higher education sector, considering its substantial impact on instructional methods and enrollment patterns, we maintain the view that a future public health event of comparable magnitude could again influence demand and finances.

Key Statistics

Table 1

University of Western Ontario--Key statistics

(Mil. C\$)	--Fiscal year ended April 30--					Medians*
	2024bc	2023	2022	2021	2020	
Enterprise profile						
Full-time equivalent enrollment (FTE; no.)	39,422	38,060	36,904	35,258	33,737	41,783
Annual FTE change (%)	3.7	3.0	4.7	4.5	1.1	MNR
Undergraduate selectivity rate (%)	68.7	67.1	63.5	66.3	53.4	73.2
Undergraduates as a % of total FTE enrollment	82.3	82.1	81.4	82.3	81.3	80.2
Retention rate (%)	93.1	92.5	92.0	93.0	94.5	86.8
Graduation rates (six years) (%)	83.9	83.7	84.5	85.0	82.9	71.0
Financial profile						
Adjusted operating revenue	1,501.4	1,426.4	1,444.6	1,280.4	1,290.2	2,148.4
Adjusted operating expense	1,385.6	1,299.4	1,183.9	1,106.5	1,160.7	2,030.5
Net adjusted operating margin (%)†	8.4	9.8	22.0	15.7	11.2	3.2
Student dependence (%)	36.5	36.7	34.2	35.6	35.1	37.0
Government operating grant dependence (%)	17.5	18.8	18.6	21.0	20.6	17.3
Endowment and investment income dependence (%)	7.2	8.6	7.8	18.0	3.1	MNR
Cash and investments	3,078.9	3,024.4	2,896.8	2,717.6	2,281.2	2,837.6
Cash & investments to adjusted operating expenses (%)	222.2	232.8	244.7	245.6	196.5	115.3
Outstanding debt	312.1	319.3	327.4	344.6	352.6	1,142.8

Table 1

University of Western Ontario--Key statistics (cont.)

(Mil. C\$)	--Fiscal year ended April 30--					Medians*
	2024bc	2023	2022	2021	2020	
Cash & investments to debt (%)	986.5	947.1	884.8	788.6	647.0	278.4
Maximum annual debt service/total operating expense (%)	2.3	2.4	2.7	2.9	2.8	3.4

bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. †As % of adjusted operating expense. *For 'AA' rated U.S. public colleges and universities. U.S. median figures are in U.S. dollars.

Ratings Score Snapshot

Table 2

University of Western Ontario--Ratings score snapshot

Industry risk	2
Economic fundamentals	1
Market position	2
Management & Governance Score	2
Enterprise risk profile	2
Financial performance	2
Financial Resources Score	1
Debt and contingent liabilities	2
Financial Risk Profile score	2
Stand-alone credit profile	aa
Issuer credit rating	AA

S&P Global Ratings bases its ratings on not-for-profit education providers on the seven main rating factors listed in the table above. S&P Global Ratings' "Global Non-For-Profit Education Providers," published on April 24, 2023, summarizes how the seven factors are combined to derive each not-for-profit education provider's stand-alone credit profile and issuer credit rating.

Related Criteria

- Criteria | Governments | General: Global Not-For-Profit Education Providers, April 24, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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 Divergence Continues, Dec. 7, 2023
- U.S. Not-For-Profit Public College And University Fiscal 2022 Medians And Ratios: Road To Recovery Is Paved With Federal Funding; Hazards Remain, July 25, 2023

Ratings List

Ratings Affirmed

University of Western Ontario

Senior Unsecured	AA
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Ratings Affirmed; Outlook Action

	To	From
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University of Western Ontario

Issuer Credit Rating	AA/Positive/--	AA/Stable/--
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