STANDARD & POOR'S — CANADIAN RATINGS

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University of Guelph

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AFFIRMED

ISSUER CREDIT RATING	
University of Guelph	
Issuer Credit Rating	AA-/Stable/--
AFFIRMED RATING	
University of Guelph	
Sr unsecd debt	
Local currency	AA-
Issuer credit rating history:	
Sept. 24, 2002	AA-

Rationale

The ratings on University of Guelph are supported by:

- A strong demand profile, boosted by the Province of Ontario's double cohort (grades 12 and 13, graduated simultaneously in June 2003, with elimination of grade 13 thereafter) in 2003-2004 in the near term, that provides ongoing enrollment predictability and stability;
- A conservative approach to finances as evidenced by a manageable debt burden, consistent annual operating surpluses, and a strong endowment portfolio;
- A substantial real estate portfolio that could be monetized to increase the university's unrestricted resource base; and
- A strong academic and research profile, particularly in agriculture, veterinary medicine, and sciences, that provides greater tuition-setting flexibility in these programs.

The ratings are constrained by:

- Rising staff costs relating largely to growing staff numbers and increasing unfunded, nonpension post-retirement obligations, as well as increased university contributions to the staff pension fund as a result of an unfunded pension deficit as at April 2003; and
- Challenges common to all Canadian universities, including the completion of sizable capital building projects within compressed time frames to meet student growth estimates.

Outlook

The stable outlook reflects Standard & Poor's Ratings Services' expectation that Guelph will continue to prudently manage its finances and that funding support from the provincial government will remain strong, while the university continues to benefit from unregulated tuition-setting flexibility in certain programs. The ratings and stable outlook are predicated on the university maintaining adequate control over major expenditures, especially salaries and unfunded post-retirement obligations, to maintain an adequate level of operating surpluses.

Strong Demand

Guelph has adopted a conservative approach to the management of its student base by imposing a self-determined limit on the number of full-time enrollment equivalent (FTE) students of about 18,000 by 2008, compared with about 16,200 currently. Its forecasts and strategies involving capital facilities and related funding continue to reflect this prudent position. Guelph is likely to benefit from strong applicant growth in the near to medium term due to the effect of the double cohort, as well as general demographic growth in the applicant base and university participation rates. Guelph's close proximity (an hour west of the center of the Greater Toronto Area) positions it to benefit from the growth in this notable university-aged population cluster.

The imposition of a cap on student numbers will allow Guelph to be selective with respect to student acceptances, with the potential to improve student quality further. Guelph's level of student aid contributions is substantial at 24.4% of consolidated revenue for 2002-2003, while its first-year student residence guarantee and high-quality research strengthen demand for the university's courses. Also adding to Guelph's demand profile, a recent study by the Globe and Mail, surveying students across the country, ranked the university third nation-wide in the quality of education category.

Table 1 University of Guelph Demand Statistics

2002-2003 tuition rates (C$)	
Domestic	4,106-30,920
International	8,910-37,106
2002-2003 student quality metrics (%)	
Average entry grade	83
Graduate rate	89
Retention rates	91

Table 2 Full-Time Enrolment Equivalent Student Statistics

FTE	Undergraduate	Graduate	Total	Growth rate (%)
2006-2007p	15,781	2,033	17,814	0.5
2005-2006p	15,691	2,033	17,724	(0.6)
2004-2005p	15,816	2,016	17,832	2.9
2003-2004p	15,377	1,954	17,331	6.9
2002-2003	14,350	1,859	16,209	7.5
2001-2002	13,388	1,688	15,076	4.7
2000-2001	12,780	1,619	14,399	4.9
1999-2000	12,173	1,547	13,720	5.8
1998-1999	11,452	1,519	12,971	2.6
1997-1998	11,160	1,480	12,640	(0.9)
1996-1997	11,225	1,528	12,753	2.4
1995-1996	11,217	1,235	12,452	(6.8)
1994-1995	11,975	1,381	13,356	N.C.

p-Projected. N.C.--Not calculable.

Table 3 Application and Acceptance Statistics 2003-2004

Program 2003-2004 (Fall 2003)	Applicants	Offers	Acceptances	Registrations	Offer yield % (offers/appl.)	Accept. rate % (acc./offers)	Regist. yield % (matric. rate)
Arts	18,928	8,526	1,389	1,383	45.0	16.3	16.2
Business	6,294	2,723	904	871	43.3	33.2	32.0
Professional	3,491	1,602	680	653	45.9	42.4	40.8
Science	12,158	6,047	1,804	1,786	49.7	29.8	29.5
Total	40,871	18,898	4,777	4,693	46.2	25.3	24.8

In 2003-2004 the university accepted 4,600 students, more than its initial enrolment target of 4,000 due to an increased demand for business and science-related courses, where demand has historically been strongest. Guelph's aggregate offer yield (46%) is average and its aggregate matriculation (yield rate) ratio (25%) is slightly low by peer comparison; however, the figures might reflect a degree of self-selection as Guelph, unlike many universities, publishes minimum acceptance standards by program.

Table 4 Major Revenue & Expenditure Components	--Year ended April 30--					
	2003	2002	2001	2000	1999	1998
As % of total revenue						
Provincial grants						
Ministry of Training, Colleges and Univesities	25.0	26.0	26.4	26.2	26.2	27.4
Ministry of Agriculture and Food	11.4	12.4	13.5	14.5	16.2	17.0
Tuition	17.9	17.4	17.3	17.5	15.8	15.5
Sale of goods and services (auxiliary)	19.7	19.7	20.1	19.8	18.4	14.8
Provincial grants per FTE (C$)	10,042	7,149	7,144	6,662	6,818	6,979
As % of total expenditures						
Salaries & benefits	59.1	58.3	59.9	60.5	61.7	62.2
Operating costs	25.0	25.7	25.6	25.3	24.9	24.7

Income

In addition to strong provincial grant support, the ratings on Guelph also recognize Ontario's tuition-setting framework, which allows universities full autonomy (for unregulated fees) in establishing graduate and international student fees and ancillary student fees. Undergraduate tuition rates remain regulated; however, the province has approved 2% annual increases to undergraduate tuition through to 2004-2005 in recognition of the rising cost burden at universities. Undergraduate tuition rates in Ontario are currently at much higher levels (about C$4,106) than in many other provinces, including Quebec and British Columbia. Higher absolute tuition rates provide greater revenue for universities and mitigate, to some extent, undergraduate rates which are regulated with only limited annual increases.

The composition of revenues is not expected to change significantly in the near term, although a recent change in the Ontario provincial government could have future funding implications for Ontario universities. The newly elected Liberal government's education manifesto promised a two-year tuition freeze for tuition fees, although the extent and practical implications have not been formalized or disclosed. Changes to the funding regime of publicly funded universities could affect the credit profile of the sector and individual universities, and Standard & Poor's will continue to assess the proposed tuition freezes in this light. This would somewhat reduce the tuition-setting flexibility at an undergraduate level, although the major tuition upside for universities is evidenced in the fully unregulated post-graduate and international programs. Guelph's reasonably high proportion of students (about 12%) enrolled in graduate programs, which carry no tuition-setting restrictions, provides a degree of revenue flexibility for the university.

The university's strong and unique foundation and operations in agricultural academics and research provide it with annual grants from Ontario Ministry of Agriculture and Food. These grants are exclusive to Guelph and account for about 11% of its revenue, helping enhance the university's revenue stream.

Guelph employs a conservative management strategy and has demonstrated its ability to manage fiscal challenges in the past. This provides Standard & Poor's with comfort that the university can accommodate some future stresses to its financial position or manage through possible changes that might be introduced by the new Liberal government.

Expenses

As with all universities, Guelph's cost structure reflects its labor-intensive service offering, with personnel and benefits accounting for about 59% of 2002-2003 total expenditures. Controlling personnel expenditure is likely to be the most significant fiscal challenge for Guelph, particularly as about 170 faculty members might have to be added between 2001 and 2007 to manage retirements and student growth demands. With a growing scarcity of qualified academic staff, cost pressures could emerge in meeting this personnel growth target. Guelph, like most universities, has limited expenditure flexibility resulting from its high proportion of personnel costs and a rigid labor environment implied by a high proportion (greater than 80%) of tenured faculty. Guelph enjoys positive cashflow from operating activities of 6.4% of 2003 revenues that allow marginal flexibility to absorb growth in personnel-related costs.

Capital Program

The university has embarked on a capital expansion program to accommodate the gradual buildup of students to 18,000 by 2008. Rozanski Hall, with its state-of-the-art lecture facilities, was completed in 2002, while a new science complex is due to open in September 2004 where construction is on schedule. No additional debt financing is envisaged for future projects, as the C$100 million debenture issue in 2002 has more than provided the financing requirement of these projects.

The university has a C$200 million deferred maintenance backlog with an annual maintenance capital expenditure of about C$5 million. The university does not expect that it will seek external debt financing to fund this obligation, but continues to fund it on a pay-as-you-go basis. Although most universities are faced with this problem and are attempting (mostly unsuccessfully) to obtain specific grants from their respective provinces to fund this spending, a sustained period of underinvestment in essential maintenance will erode asset values and place further pressure on future maintenance obligations. In its most recent independent survey, Guelph had no major asset failings and has assigned an order of priorities to deal with the backlog. As part of its capital program, facilities that had a high deferred maintenance component have already been earmarked for demolition or renovation.

Guelph's first-year residence guarantee could cause the university to build additional residences as student population grows in the next several years. The university recently built a 645-bed townhouse-style residence; however, Guelph considers additional accommodation alternatives, including off-campus residences built on university property that are built, financed, and operated by private developers. Standard & Poor's does not expect the university to be exposed to occupancy or usage risk under such a financing proposal.

Debt Profile

In 2002, Guelph issued a total of C$100 million in bullet, unsecured debentures, of which C$75 million was used for the capital program described above. A total of C$25 million of the debt proceeds that was not used for projects was used partially to repay existing debt and partially to renovate current academic facilities.

The university will be starting a discretionary sinking fund shortly to make systematic payments to ultimately retire principal in 2041. The ratings reflect the expectation that accumulation of the sinking fund will continue as if the university were compelled to do so by a formal covenant.

Guelph's debt burden is around C$10,500 per FTE for the 2003-2004 academic year. The debt burden is about 37% of 2002-2003 total revenue, and Guelph's estimated debt service burden (including an allowance for sinking fund contributions), as a percentage of total revenue, will be about 2.8%. These debt metrics are average compared with those of other presently similarly rated Canadian universities, such as York University and University of British Columbia. Residentially intensive universities, such as Guelph, which has about 90% of first-year students living in university accommodation, typically carry slightly higher debt per FTE burdens. From a credit perspective, that higher debt burden per student is not necessarily viewed negatively, because residence assets are generally priced on a full cost recovery basis, including financing costs.

Pension and Other Retirement Obligations

For the year ended April 2003, the university's three pension plans reflected an aggregate deficit of C$84 million compared with a surplus of C$40 million in 2002, a swing of C$124 million. Weakness in financial markets, combined with a lower discount rate used to value the pension obligation, is a common theme in the Canadian higher education sector and continues to place financial pressure on universities. Guelph's investment losses are average compared to investment performance benchmarks, but the university will still have to take steps to redress its pension deficit. A new investment manager has been hired, a more conservative asset mix has been adopted, and actuaries have been engaged to formally review funding policies. These strategies are a first step toward restoring the financial health of the retirement plans, but require successful implementation before the university can claim to have fully addressed the deficit. More tangible evidence was a one-off C$10 million university contribution to the pension funds in 2002-2003, as well as future increased cash contributions that the university ultimately expects to restore the retirement fund to surplus. The employment of staff on less rigid salary packages should also reduce the retirement obligation of the university.

Post-retirement, nonpension liabilities such as medical and dental benefits are generally unfunded; nearly all Canadian universities carry such a pay-as-you-go financial obligation. Guelph's unfunded position was C$92 million in 2003 compared with C$85 million in 2002. These obligations place a further burden on the university's operating margins and are likely to increase in time, should the liability continue to increase.

On a pro forma basis, when unfunded post-retirement obligations are included in debt, debt per FTE rises to C$16,300 from C$10,500 and to 58% of revenue from 37%. From a credit perspective, it is not so much the magnitude of the debt-like nature of these obligations, but the increased impact on expenditures to meet these obligations, where funds from operating activities, although positive at 6.5% of revenue, remains thin. Standard & Poor's expects the strategies adopted by the university to have an impact on the unfunded post-retirement position. If they do not, continued growth could place downward pressure on the ratings on the university.

Endowment, Development Initiatives, and Asset Position

The university endowment comprises a general endowment fund and the Heritage Fund, which includes real estate designated for sale or land lease, and an endowed pool of marketable securities. Standard & Poor's notes that these endowment figures do not include about C$75 million in marketable real estate assets at the university's discretion.

Guelph had a total endowment of C$120 million in 2003 and an average endowment per FTE among Ontario universities of C$7,400 that has declined from C$8,800 in 2002 through a combination of weak asset performance and an increased number of FTE students. In addition, C$19 million was allocated from previous year's income to fund investment losses and fund spending commitments. But, C$86 million of these endowed assets is externally restricted, which diminishes the value of that portion of the endowment somewhat from a credit perspective. In 2002, the university achieved C$80 million of fundraising compared with its campaign target of C$75 million, a significant achievement given current market conditions.

Guelph is fortunate to possess noncore real estate assets (C$75 million of marketable real estate noted previously) that can be monetized through sale, development, or long-term lease. These potential real estate transactions represent significant value to a university's unrestricted resource position, which could have a notable effect in enhancing credit quality through the increase in liquidity and a reduction in net debt. The properties might also reduce pressure to provide student accommodation, as they could be leased on a long-term basis to private developers who will provide such student housing.

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