STANDARD & POOR'S

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University of Guelph

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University of Guelph

Major Rating Factors

Issuer Credit Rating
A+/Stable/--

Strengths:

- Strong student demand and quality metrics, supported by an academic niche and research profile
- Improving operating results
- Good provincial financial support

Weaknesses:

- Weaker expected balance sheet
- Substantial unfunded postemployment liabilities

Rationale

The ratings on University of Guelph (UoG) reflect Standard & Poor's assessment of the university's strong enrollment demand, supported by an academic niche and research profile, improving operating results, and good provincial financial support. A weaker expected balance sheet and significant unfunded postemployment liabilities constrain the ratings.

More specifically, we believe UoG's credit strengths include the following:

- Strong student demand and quality metrics, supported by an academic niche and research profile. Despite UoG's enrollment increasing 22% since fall 2006 to 25,194 full-time equivalents (FTE) in fall 2011, its student demand and quality metrics have not diminished during that time. UoG is predominately an undergraduate institution. About 10% of its 25,194 FTE enrollment in fall 2011 was at the graduate level, significantly lower than the 18% of most rated Canadian research-intense universities. Even so, its unique and notable research component, namely its multifaceted agrifood initiative sponsored by the Ontario Ministry of Agricultural Farming Rural Affairs (OMAFRA), has helped enhance Guelph's research profile and attract graduate students to the university, despite fierce competition from other Ontario universities.
- Improving operating results. In fiscal 2011 (year ended April 30, 2011), the university's revenues grew faster than expenditures. Its full accrual surplus was 3.8% of total revenues. Prior to this, since fiscal 2004, UoG had full accrual deficits, ranging from 0.4%-3.1% of total revenues, which deepened its unrestricted deficit to C$253 million by fiscal 2011 (from a modest surplus in fiscal 2004). The overwhelming majority of the deficit relates to UoG's accrued employee future benefits costs (a noncash expense). However, the university has a well-established history of consecutive surpluses on a modified accrual basis (adjusting for amortization and depreciation), which was 6.5% of adjusted revenues in fiscal 2011.
- Good provincial financial support. Ongoing support from the province, including the OMAFRA contract, accounts for about 35% of total revenues. In addition to its base operating grants (provided on a weighted FTE basis), the province also has a history of providing additional grant envelopes, or one-time year-end disbursements for alleviating operating and capital pressures. However, given Ontario's large deficit, its medium-term financial support to universities could be constrained. Nevertheless, we believe that given our assessment of the university's important role in the province and its strong link to it, Ontario's operating and

special envelope grants to the university should not substantially diminish in the next two years.

Offsetting credit weaknesses include the following factors:

- Weaker expected balance sheet. In our opinion, a good measure of balance-sheet strength is unrestricted financial resources as a share of debt. UoG's unrestricted financial resources (internally restricted net assets plus internally restricted endowments) were C$177 million, or 95% of debt in fiscal 2011. This is the university's strongest level and ratio for this measure to date, mostly accumulated to manage its expected significant pension deficit payments. As a result, we expect its unrestricted financial resources to weaken to about 50% of debt by fiscal 2014. This is also because we expect UoG's debt to rise to C$226 million by fiscal 2014 from C$185 million in fiscal 2011 for various capital projects, in accordance with its five-year capital financing plan. Even after factoring in UoG's expected weaker balance sheet, by fiscal 2014 the university's ratios should still be consistent with the ratings.
- Substantial unfunded postemployment liabilities. In fiscal 2011 the university had a C$221 million accrual pension deficit, and a C$263 million nonpension, postemployment liability. Based on the results of an Aug. 1, 2010, actuarial valuation, its defined benefit pension solvency deficit was C$344 million, which is legislatively required to be repaid within five years. However, the province has allowed universities to apply for three-year solvency relief. UoG was approved for this relief, which substantially reduces its annual pension-related payments to C$36 million (from C$97 million) until Aug. 1, 2014, or 5% of total fiscal 2011 revenues. UoG has built reserves and incorporated larger pension contributions in to its operating budget, although the payments should still squeeze its budget and place considerable strain on the university's resources.

Outlook

The stable outlook reflects our expectation that in the next two years UoG will maintain its strong student demand profile, and that its operations will continue to be in surplus. The outlook also reflects our expectation that the province's base operating financial support to the university will not diminish, and that UoG will manage through the required pension payments and its capital plans without its unrestricted financial resources and debt ratios weakening further than expected on a sustained basis. Factors that could put downward pressure on the ratings include a substantial increase in its pension deficit accompanied by significantly greater-than-expected mandatory payments, a greater-than-expected rise in debt, significantly lower-than-expected unrestricted financial resources, or persistent operating deficits. Substantially reduced unfunded postemployment liabilities, a significant decline in debt, or a permanent rise in unrestricted financial resources could place upward pressure on the ratings.

Government-Related Entity Methodology: Moderately High Likelihood Of Extraordinary Provincial Government Support

In accordance with our criteria for government-related entities (GREs), our view of a "moderately high" likelihood of extraordinary government support reflects our assessment of UoG'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), and that there are no viable private alternatives. It also reflects our view of the university's unique solid reputation which is bolstered by its niche and research profile. We believe the provincial oversight and directive Guelph receives through tuition regulation and program approval suggests a "strong" link with the province. Also supporting this view is that provincial operating grants account for about 35% of the university's operating revenue.

Student Demand and Quality Metrics Remain Strong Despite Considerable Enrollment Growth

In fall 2011 FTE enrollment was 25,194, rising about 4,600 FTEs, or 22%, since fall 2006. Fall 2011 total applicants grew 2% from the previous fall, similar to the university's five-year (falls 2006-2011) average growth. Selectivity (offers/applicants) in fall 2011 was 59%, not very different from the University of Toronto's (AA/Negative/--), or the University of Western Ontario's (AA/Negative/--). Fall entrance averages have been steady at about 82% from 2006-2011.

Nontraditional students play more significant role in enrollment strategy

Most of UoG's enrollment growth since 2006 was at the undergraduate level, largely stemming from growth at the main campus, in addition to the university's joint venture with Humber College (Guelph-Humber). Guelph-Humber's enrollment grew to 3,600 FTEs in fall 2011, since its initial fall 2002 student intake. The province is expecting an influx of up to 60,000 students in the Greater Toronto Area (GTA) during the next five years. The university hopes to capture some of this demand given that Guelph-Humber is located in the heart of the GTA. To maintain enrollment levels at the main campus, the university is stepping up its efforts to attract nontraditional students (such as those transferring from colleges and other Ontario institutions, as well as out-of-province and international students). This strategy coincides with the province's support for a new credit transfer system and better institutional mobility.

UoG is also focused on expanding its graduate capacity thanks to its well-entrenched agrifood niche. It expects to achieve its graduate enrollment target (an initiative financially supported by the province since 2008) by fiscal 2012. UoG plans to expand graduate enrollment by up to an additional 300 students by fiscal 2016, which is also part of an initiative financially supported by the province.

Improved Operating Results

Restructuring initiatives help contain fiscal 2011 expenditures

UoG's restructuring initiatives helped contain its fiscal 2011 expenditures to a 2.5% pace of growth (largely from salaries). In particular, the university's buy-out program has helped keep its staff complement stable and resulted in moderate salary (which account for 48% of total revenues) increases, largely from negotiated compensation increases. Also helping to contain expenditures was a decrease in pension and nonpension benefit expenses (which account for 14% of total revenues), partly stemming from increased asset values. Revenues, on the other hand, grew 7.0%, led by provincial grants, including those related to the OMAFRA contract, followed by tuition revenues.

Plan to reduce operating component of structural deficit

The university's net asset deficit grew C$42 million in fiscal 2011 to C$253 million. As in previous years, the increase largely reflects accounting charges to postemployment benefits. Because these charges are based on current market conditions, they can be volatile. Instead of funding these charges, UoG, similar to many other Canadian universities, makes legislatively required pension contributions based on actuarial valuations. Also similar to most other universities, its nonpension postemployment liabilities are funded on a pay-as-you-go basis. However, C$47 million of the deficit relates to UoG's operating fund deficit, which it accumulated through retirement incentive and restructuring program costs. As part of its multiyear plan to repay the restructuring costs, the university implemented a budget provision to reduce the deficit by C$6 million annually for the next seven years, beginning fiscal 2012.

Good provincial support

In our opinion, financial and policy support from the province is good, and in part helps underpin the ratings. Provincial grants for UoG's core operations (excluding the OMAFRA contract) account for 26% of total revenues. The university's revenues from the province are generally more diverse than those of its Ontario peers. This largely is thanks to its OMAFRA contract, which, at C$62 million annually, accounts for more than 9% of its total revenues. This envelope includes about C$11 million in additional funding for research support, which ends in 2013. Management believes that the C$11 million could be cut when the contract is renewed in 2014. To adjust to the lower grants, UoG indicated that it is prepared to make difficult expenditure cuts, including eliminating the hiring of graduate students for OMAFRA-related work.

UoG and other universities could increasingly be forced to make budget adjustments in the next two years. This is because Ontario's operating environment is restricted, and we expect the province's financial support to universities could be constrained in the medium term, particularly one-time year-end funding. However, we expect that base operating grants, and most funding envelopes (including the core funding components of the OMAFRA contract) will not diminish. In fact, the province has signaled its commitment to postsecondary education by promising to fund up to 60,000 additional student spaces (including colleges and universities) during the next five years, beginning fiscal 2012.

Tuition framework uncertainty

Ontario's tuition-framework permits universities to increase tuition by a maximum annual average of 5% institution-wide. Given the limited growth in government grants, and that tuition is the second largest source of revenue (accounting for about 20% of the total), UoG has made full use of this limit in the past several years. The province extended the current tuition framework to fiscal 2013. There is tuition policy uncertainty beyond that period, although a provincial commissioned review of government spending (the Drummond report) recommended maintaining the current tuition framework. Also, given the growing public concern for education affordability and accessibility, we believe that further tuition flexibility is unlikely in the next two years.

Operations should balance in the next two years

Management expects both an operating and full accrual surplus in fiscal 2012. According to its multiyear plan for fiscals 2013-2017, UoG's operating budget should balance in fiscal 2013. It has identified budgetary shortfalls in the following years, although it plans to eliminate these through annual revenue increases and cost reductions. Even so, given the university's already-tight operating environment, and its recently implemented restructuring initiatives, we believe that finding ways to balance its budget may prove challenging.

Five-Year Capital Plan Aims To Contain Deferred Capital Maintenance

Government capital funding, such as the Knowledge Infrastructure Program (KIP), and high priority campus infrastructure needs, are keeping capital spending at high levels. In fiscal 2011 UoG acquired C$106 million in capital assets. The bulk of this was for equipment purchases and building renovations (C$24 million), Alexander Hall renovations (C$20 million), labs for the Ontario Veterinary College (C$15 million), and phase 1 of an engineering school expansion (C$13 million). During that period it recognized C$27 million in government capital contributions. About C$20 million of this was KIP funding for repurposing the Axelrod building.

UoG plans to spend about C$116 million during fiscals 2012-2013. The bulk of spending will be for an engineering school expansion, estimated at C$48 million, about C$36 million of which will be debt financed. About C$37 million will be for an adaptive re-use of the Alexander Hall building, of which about C$34 million will be from KIP funding, and the remainder from debt financing. Research funding will pay for a C$14 million biodiversity genomics centre.

The university's estimated deferred capital maintenance is high relative to that of its peers, at almost C$300 million (C$200 million for campus buildings, C$40 million for repair of residences, and C$45 million for utilities infrastructure). UoG's five-year (2012-2016) capital renewal financing plan is intended to at least contain its deferred maintenance. The engineering school expansion and the Alexander Hall adaptive re-use project are part of this plan. The capital financing plan outlines medium-term borrowing requirements, although expenditure and funding estimates can significantly diverge from year to year for various reasons (including unexpected government funding, variances from budget, delays, or change in scope). If UoG executes its five-year plan as scheduled, the university estimates that its debt, and the servicing of it, will remain within its debt policy limits. We view such internal guidelines as a positive reflection of management's financial planning.

Rising Debt To Help Finance Capital Plan

In fiscal 2011 UoG's debt was C$185 million, or 28% of adjusted revenues, similar to ratios since 2006. Its debt service coverage ratio and interest expense were 1.86x and 1.80% of adjusted revenues, respectively. These metrics are UoG's strongest metrics since the university's first debt issuance in 2003.

The majority of UoG's current debt consists of the C$100 million in senior unsecured bullet debentures issued in 2002 and maturing in 2042. The debenture financed major academic buildings, including C$86 million for Rozanski Hall, the McKinnon extension, and the Science Complex, and C$14 million for deferred maintenance. The university has established a voluntary internal sinking fund to provide for debt retirement. In fiscal 2011, UoG issued C$10 million in bank debt, and used C$4 million of its voluntary sinking fund to make principal payments. As of fiscal 2011, UoG's sinking fund was C$14 million, about C$5 million of which will be reinvested for the purpose of retiring the C$100 million debenture.

UoG issued C$37.8 million in fiscal 2012. According to its five-year capital financing plan, by fiscal 2014 its debt could reach C$226 million, or 33% of our estimate of the university's adjusted revenues at that period, and its debt service coverage ratio could drop to 1.76x. These ratios are weak compared with those of its peers, but consistent with the rating. By fiscal 2016 its debt could reach C$243 million. Given that this is beyond our two-year rating horizon, we will assess to what extent the added debt weakens its financial measures at that time.

The university has entered various interest-rate swap agreements with equally or higher-rated counterparties. These include Bank of Montreal (A+/Stable/A-1), Toronto Dominion Bank (AA-/Stable/A-1+), and Canadian Imperial Bank of Commerce (A+/Stable/A-1). The swap agreements synthetically fix the university's variable-rate debt and are intended to be held to maturity.

Pension Solvency Funding Manageable For Now

In fiscal 2011, despite a more than C$117 million rise in pension assets, changes in actuarial assumptions (namely lower discount rates) increased the accrual pension deficit by C$32 million to C$221 million. Based on an Aug. 1, 2010, actuarial valuation, UoG's solvency pension deficit was C$344 million. UoG was approved for stage 1 of the province's solvency relief, which substantially reduced its annual pension-related payments to C$36 million until Aug. 1, 2014 (from an initial C$97 million). Stage 2 of the province's solvency relief extends the amortization of solvency payment period to 10 years from five. The relief is conditional on the university achieving certain savings targets for its plans. After receiving the results of its next actuarial valuation filing, which must be by Aug. 1, 2013, UoG will submit its stage 2 proposal. Given that union groups and associations have agreed to structural plan changes (including employee contribution increases), the university believes that it should be granted stage 2 relief. The 10-year amortization payment period associated with stage 2 relief would commence Aug. 1, 2014. Even with the extended repayment period, UoG estimates annual payments to be C$61 million for Aug. 1, 2015 and about C$70 million thereafter. Management has built reserves and incorporated larger pension contributions into the operating budget for making the pension-related payments, which it believes should sufficiently fund, up to and including, its Aug. 1, 2015 payment. We expect that the payments will draw down UoG's unrestricted financial resources in the next two years.

UoG also had a C$263 million nonpension postemployment liability based on its fiscal 2011 audited statements. Because there is no legislative requirement to maintain assets against these liabilities (unlike pensions), the university funds these on a pay-as-you-go basis, similar to other universities.

Internally Restricted Resources Built-Up In Anticipation Of Significant Solvency Payments

Fueled by positive investment returns and C$10 million in endowment contributions, the market value of UoG's endowment grew 15% in fiscal 2011 to C$218 million, a new watermark high. This reflects 51% growth from fiscal 2009, a low point in the endowment's value due to global financial turbulence.

The portion of endowments that contributes to UoG's balance-sheet flexibility, or internally restricted funds, is C$21 million. The university also had C$155 million in internally restricted net assets, bringing its total internally restricted resources to C$177 million, its highest level to date. This represents about 95% of debt, which is stronger than the average and median for the rated Canadian peer group (UoG is the lowest rated institution within the peer group). The university has built its financial flexibility in anticipation of the substantial pension funding requirements. Incorporating UoG's planned debt, by 2014, we estimate that its internally restricted financial resources could weaken to about 50% of debt, lower than the peer group's present median and average. However, this ratio is still stronger than it was prior to fiscal 2009, and is consistent with the rating.

Furthermore, the university has raised C$129 million in receipts and pledges as part of a C$200 million fundraising campaign (with a target date of 2014). The majority of the funds raised will likely have external restrictions, which tends to be the case for about 90% of UoG's total endowment. However, in our opinion, even these provide strength, by producing spendable endowment income and freeing up other operating funds that management can use for other purposes. Furthermore, endowments restricted for scholarships or faculty chairs enhance a university's profile, attracting quality students and faculty.

Solid Research Profile

A major component of the university's research is its multifaceted agrifood initiative that OMAFRA sponsors. In addition to accounting for about 34% of UoG's research funding, the OMAFRA contract gives the university a strong niche among Ontario's 19 universities. In fiscal 2011, UoG received C$153 million in research funding, its highest level to date. Despite being restricted, research grants contribute significantly to the university's operations by attracting faculty and covering the costs of expanding faculty and capital, which relate to research.

University of Guelph -- Peer Comparison

	University of Guelph		York University		McMaster University		University of Western Ontario	
Thou. C$ (except FTE and ratios)	2011	2010	2011	2010	2011	2010	2011	2010
Issuer credit rating	A+/Stable/--	A+/Stable/--	AA-/Stable	AA-/Stable	AA-/Stable/--	AA-/Stable/--	AA/Negative/--	AA/Negative/--
Applicants	26,106	27,427	58,402	58,210	31,046	30,970	32,744	31,587
Offers	15343	14,678	40,879	41,812	19,631	19,644	19,289	18,367
Registrants	5332	4,302	N.A.	N.A.	5,019	5,016	3,944	3,630
Acceptance Rate (Offers/Applicants) (%)	59	54	70	72	63	63	59	58
Yield (Registrants /Applicants) (%)	20	16	N.A.	N.A.	16	16	12	11
FTEs	20,619	19,772	47,894	46,644	25,399	25,007	29,913	28,987
Total revenue	678,404	634,034	923,016	890,385	859,507	828,373	994,995	961,065
Deferred capital	22,442	21,372	11,698	12,846	34,688	36,386	29,962	31,765
Adjusted revenue	655,962	612,662	911,318	877,539	824,819	791,987	965,033	929,300
Total expenditure	652,553	636,624	926,551	894,803	837,556	816,723	952,204	915,262
Total interest expense	11,836	11,278	19,591	21,060	9,900	9,969	10,790	11,163
Depreciation	39,257	38,541	39,959	41,225	61,115	62,474	66,066	67,199
Adjusted expenditure (For DSCR)	601,460	586,805	867,001	832,518	766,541	744,280	875,348	836,900
Current portion of long-term debt (for calculating DSCR)	17,543	3,658	4,430	4,181	12,744	1,128	1,510	2,391
Consolidated surplus (%)	3.8	(0.4)	(0.4)	(0.5)	2.6	1.4	4.3	4.8
Consolidated surplus (for calculating DSCR; %)	8.3	4.2	4.9	5.1	7.1	6.0	9.3	9.9
DSCR (interest and principal; x)	1.86	1.73	1.8	1.8	2.6	4.3	7.3	6.8
DSCR (interest only; x)	4.60	2.29	2.3	2.1	5.9	4.8	8.3	8.3
Total debt	185,060	179,082	310,941	315,123	174,143	173,270	216,034	218,411
Unfunded post-employment liabilities	484,246	409,976	361,997	353,581	480,964	579,116	272,486	247,332
Interest expense to adjusted revenue (%)	1.8	1.8	2.1	2.4	1.2	1.3	1.1	1.2
Debt to FTE	8,975	9,057	6,492	6,756	6,856	6,929	7,222	7,535
Debt to adjusted revenue (%)	28	29	34	36	21	22	22	24

University of Guelph -- Peer Comparison (cont.)								
(Debt plus unfunded)/adjusted revenue (%)	102	96	74	76	79	95	51	50
Internally restricted net assets	156,483	115,117	148,502	160,199	6,416	(1,740)	165,680	115,046
Internally restricted endowments	20,133	18,561	40,533	36,324	114,833	107,817	19,567	15,949
Externally restricted endowments	190,242	162,230	290,799	257,496	329,272	287,854	342,840	302,930
Unrestricted financial resources	176,616	133,678	189,035	196,523	121,249	106,077	185,247	130,995
As % of total debt	95	75	61	62	70	61	86	60
As % of total debt plus unfunded post-employment liabilities	26	23	28	29	19	14	38	28
As a % of operating expense	27	21	20	22	14	13	19	14
Per FTE	8,566	6,761	3,947	4,213	4,774	4,242	6,193	4,519
Total endowment value per FTE (at market value)	10,573	9,574	7,057	6,303	20,201	18,425	12,115	11,001

FTE--Full-time equivalent. DSCR--Debt service coverage ratio. N.A.--Not available.

Related Criteria And Research

- Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010,
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- USPF Criteria: Higher Education, June 19, 2007
- USPF Criteria: Non-Traditional Not-For-Profits, June 14, 2007

Ratings Detail (As Of June 7, 2012)	
University of Guelph	
Issuer Credit Rating	A+/Stable/--
Senior Unsecured	A+
Issuer Credit Ratings History	
28-Nov-2008	A+/Stable/--
08-Nov-2007	A+/Negative/--
25-Oct-2006	A+/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.