Research Update:

Queen's University Ratings Affirmed At 'AA+'; Outlook Is Stable

April 16, 2024

Overview

- Queen's University benefits from strong domestic demand, bolstering its enterprise profile. However, measures to contain operating expenses and attract international students will exert pressure on management.
- We expect a transitionary period, where the university will experience negative operating margins due to limited revenue flexibility and higher instructional costs, resulting in significant operating deficits in fiscal 2024 and 2025, with recovery starting in fiscal 2026.
- Despite these challenges, we expect the university will maintain its robust enterprise and financial profiles.
- Therefore, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on Queen's University.
- The stable outlook reflects our expectation that steady growth in total enrollment will uphold the university's excellent market position, while its exceptional liquidity will continue to bolster its credit profile over the next two years.

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Rating Action

On April 16, 2024, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on Queen's University, in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects our view that Queen's will sustain its exceptional market position and stable student demand over the next two years. Despite ongoing financial challenges and projected negative operating margins until fiscal 2026, we expect operations will gradually stabilize. The outlook also reflects our expectation that Queen's management will take meaningful proactive measures to balance operations. At the same time, we expect Queen's will maintain ample financial resources to support a moderate debt burden.

Downside scenario

We could lower the ratings if there's weakening in the university's market placement and falling international enrollment or if insufficient management intervention led to sustained operating deficits above 2% of adjusted operating expenses. Alternatively, we could also take a negative rating action if Queen's expanded its capital plans and incurred additional debt, such that maximum annual debt service (MADS) increased to 4%. Although unlikely, a strengthening of our assessment of the link between Queen's and the province could lead to the equalization of our ratings on the university with those on Ontario.

Upside scenario

Although unlikely, we could take a positive rating action on Queen's in the next two years if the university consistently achieves healthy operating margins. This, coinciding with stable international student enrollment and increased financial flexibility, would better align metrics with those of 'AAA' rated peers. At the same time, the ratings remain subject to the three-notch cap above the ratings on the related government.

Rationale

The rating reflects Queen's 'aa+' stand-alone credit profile, which is based on our combined assessment of the university's extremely strong enterprise profile and very strong financial profile. In addition, the rating reflects our opinion of a moderately high likelihood that the Ontario government could provide extraordinary support in the event of financial distress.

We expect Queen's will continue to attract high-quality domestic students, both within and outside the province, while international student enrollment, which is lower than that of similarly-rated peers, will remain largely stable. Our base-case forecast assumes effective cost-saving measures to restore operational balance. During this period, the university will experience increased operating deficits in fiscal years 2024 and 2025, followed by gradual strengthening in fiscal 2026. We also expect liquidity will remain a key strength and sufficient to support its moderate debt burden.

Starting in fall 2024, the Canadian government will implement a national cap on international study visa applications. This cap will result in a reduction to 364,000 approved permits, accounting for students applying for extensions, marking a 28% decrease from 2023 levels. The cap will not apply to current permit holders, primary and secondary school students, and master or doctoral students. Provinces have received allocations from the cap based on their respective populations.

We expect that Ontario, which already has a disproportionately large number of foreign students, will face a significant reduction in incoming international students. Subsequently, the province announced that 96% of its allocation will be distributed across public colleges and universities. As a result, we don't expect this to lead to a significant reduction in Queen's permit allocations. We expect Queen's will continue its efforts to attract more talent from abroad and shift its focus to retention.

Strong student quality metrics and stable undergraduate demand support Queen's enterprise profile.

The enterprise profile assessment reflects our view of the higher education sector's low industry risk; Queen's strong market position and demand profile and effective management and governance practices; and Ontario's extremely strong economic fundamentals. In the past three years, approximately 65% of the student body has been from Ontario. Hence, we assess economic fundamentals based on the province's GDP per capita (estimated at about US$55,400 in 2024), strong income indicators, and moderate projections for employment and population growth.

Established in 1841, Queen's is a midsize, research-intensive university in Kingston, Ont. It offers a diverse range of undergraduate and graduate degrees spanning eight faculties and schools: arts and science, education, engineering and applied science, health sciences, law, Bader College, commerce, and graduate studies. The university conducts innovative research in many fields, including applied artificial intelligence and analytics, chemistry, particle astrophysics, cancer trials, clean technology, geotechnical engineering, Indigenous studies, neuroscience, prisons, justice and surveillance, and art conservation.

The university is a member of the U15, an association of leading public Canadian universities collaborating on research initiatives and advocating the importance of research benefiting society. Members undertake 80% of all competitive university research in the country, and rank among the world's premier institutions. Queen's external research funding was C$183 million in fiscal 2023 (C$172 million in 2022).

In our opinion, the university's student quality metrics are strong and compare well with those of rated Canadian peers. Queen's estimates its annual enrollment for fall 2023 at 28,888 full-time equivalent (FTE) students, marking a 7.9% increase from 2022 when enrollment fell 4.9% against FTE enrollment in 2021. In general, FTEs have steadily climbed, with an annualized growth rate of 7.0% in the past five years, surpassing that of most Canadian peers. We expect overall enrollment growth will remain modest in the near term.

Although the overall proportion of international students remains relatively stable, at approximately 12.9% of total FTEs, enrollment has been declining. In fall 2023, the intake of international students was 59% of what it was in fall 2019. Meeting enrollment targets ensures the university can generate projected revenue, considering that international fees are significantly higher than domestic fees and not subject to the tuition freeze. Other than recruitment, management also faces the challenge of a lower retention rate for international students. To stabilize retention, management is offering incentives and more support, reflected through an increase in financial aid.

Overall student quality metrics remain strong and compare well with those of other Canadian universities; selectivity is more favorable for Queen's.

In our view, Queen's exhibits very strong management and governance practices that align well with those of other rated Canadian universities. We consider Queen's transparency and disclosure good, with policies, procedures, and risk management capabilities to adequately identify, monitor, and mitigate risks. The university operates within a three-year budget aligned with its strategic plan to support long-term goals. Despite the budget aligning relatively well with the long-term strategy, several years of falling short of its international student enrollment targets suggest a potential weakening or competitive disadvantage in the university's strategic positioning, placing it behind selected Canadian peers. The senior administration's operational effectiveness is evidenced by a track record of strong margins. However, management is currently challenged to expand international enrollment, and its strategic decisions will help to alleviate current operational pressures. Queen's implemented direct austerity measures to address the operating deficit caused by the financial difficulties facing the higher education sector in Ontario. In our view, management's commitment to assume responsibility for upcoming important operational decisions, to enhance transparency, and to long-term financial sustainability suggests that management remains very strong.

Stable government funding and strategic cost-saving measures will support operations, while exceptional liquidity bolsters Queen's financial profile.

In our view, despite some considerable financial pressures, Queen's overall financial profile will remain very strong. The university is facing challenges such as higher instructional costs and constrained revenue flexibility, that, compounded by stagnant growth in the share of international student undergraduates, will stress its financial performance. Therefore, we anticipate a drop in operating margins to 0.3% over five years, on average. Although fiscal 2023 returned a flat net operating margin of negative 0.4% (S&P Global Ratings-adjusted), we expect more significant deficits in both fiscal years 2024 and 2025, followed by a more modest deficit in fiscal 2026. This recovery will be spurred by student-derived revenues from high undergraduate demand from domestic students combined with successful cost-saving measures to stabilize operations. Management pursued austerity measures for cost savings in spring 2023, and we expect it will continue to do so throughout the forecast horizon.

As of Dec. 31, 2023, Queen's reported an operating fund deficit of approximately C$40.7 million in its financial projections for fiscal 2024, lower than the C$62.8 million budgeted, due to hiring freezes and higher investment income. The university funds its deficit through the use of reserves and expects to balance its operating budget by drawing down on carry-forward balances. It also plans to implement cost-saving measures to address operating shortfalls. We expect Queen's will stabilize its costs gradually, thus moving closer to balanced operations by the end of our forecast horizon.

Similar to that of Canadian peers, the university's limited flexibility to increase its student-generated revenue somewhat offsets its historically 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 we don't expect will increase in real terms).

The 10% reduction and freeze on domestic tuition fees the Ontario government implemented for the 2019-2020 academic year is in place, at a minimum, until fiscal 2027. In February 2024, the provincial government unveiled a C$1.3 billion funding package to support the higher education sector in Ontario. This funding includes a C$900 million stabilization fund to be distributed over three years, contingent on institution-specific audits and efficiency measures.

In early 2024, the Ontario government also repealed its 2019 Bill 124, which capped annual wage increases for public sector employees, including university faculty and administration, at 1% for three years, after the Ontario Court of Appeal ruled it was unconstitutional. Following this, Queen's successfully negotiated a three-year collective agreement with its faculty base. The renegotiation of its agreement with general staff, set to expire in December 2024, could potentially bring some considerable financial pressures during our outlook period.

In addition, similar to other Ontario public universities, Queen's has significant infrastructure repair needs and could benefit from the C$167.3 million funding for the sector earmarked over three years for this purpose. We expect to have a comprehensive understanding once the province releases further details.

In our view, Queen's has a moderate debt burden. At fiscal year-end 2023, total gross debt outstanding was C$376.8 million. The debt consists of four fixed-rate bullet bonds due at the earliest in fiscal 2033 and an amortizing bank loan maturing in fiscal 2031.

Nearly 90% of the debt structure consists of nonamortizing debt, with corresponding sinking funds established to coincide with debenture maturity. The next bullet maturity, the series A debenture, is in November 2032, and sinking fund requirements have been fully funded. MADS (which includes an estimated principal component for nonamortizing debt) remained moderate, at about 3.4% of 2023 adjusted operating expenditures, in line with the median for 'AA' rated peers. Based on proceeds from previous debentures still available and a moderate capital plan, we anticipate no further debt issuance throughout the outlook period.

As of July 1, 2021, the University Pension Plan Ontario (UPP), jointly sponsored by Queen's University, the University of Toronto, and the University of Guelph, covers employees and retirees from all three institutions. Trent University joined in January 2022. Assets and liabilities totaling C$2.6 billion were transferred to the UPP, which had a surplus of C$132 million. Contributions and benefits began immediately. With Queen's having entered with a strong financial position, the UPP's risk-sharing approach is expected to mitigate future deficit impacts on its credit profile.

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

Queen's credit profile is bolstered by very robust liquidity. Total cash and investments, including endowment, were C$2.5 billion at the end of fiscal 2023. This represents more than 200% of adjusted operating expenses on average, which we consider extremely strong, although almost 50% of these assets were in externally restricted endowments. Queen's has the second-highest endowment value per FTE in Canada, above C$50,000 as of April 2023. The endowment had a market value of C$1.46 billion as of the same period. The strong liquidity compares favorably with that of other rated Canadian universities. Despite our expectation of increased outflow in the outlook horizon, we remain confident that Queen's liquidity will surpass the necessary obligations for debt servicing and provide a significant buffer against medium-term pressures.

Moderately high likelihood of extraordinary provincial government support

In accordance with our criteria for government-related entities (GREs), our view of Queen'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), and that there are no viable private alternatives. It also reflects our view of Queen's role as a reputable higher education institution in Canada and its significant research capacity. The province's oversight, program approval rights, and tuition regulation over the university suggest a strong link to it. Also supporting our assessment of the link are the large operating grants received from the province, accounting for about 20% of total revenue. We rate Queen's three notches above Ontario, the maximum differential allowed in accordance with our methodology for rating GREs that we believe depend on ongoing government support. The difference reflects our view of the university's substantial financial assets. We believe there is a measurable likelihood that Queen's financial resources would meet ongoing operational and debt service requirements should the government default and temporarily suspend payments to the university. In addition, the difference reflects Queen's ownership structure, in which the government is neither an owner nor shareholder. Moreover, the province appoints none of the university's board of trustees' members. 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.

Environmental, social, and governance

We analyzed Queen'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 believe that a future public health event of comparable magnitude could again influence demand and finances.

Key Statistics

Table 1

Queen's University -- Key statistics

	--Fiscal year-end April 30--					
(Mil. C$)	2024bc	2023	2022	2021	2020	Medians*
Enterprise profile						
Full-time equivalent enrollment (FTE; no.)	28,888	26,785	28,178	26,262	25,620	41,783
Annual FTE change (%)	7.9	-4.9	7.3	2.5	2.7	MNR
Undergraduate selectivity rate (%)	39.5	41.5	47.5	38.2	39.4	73.2
Undergraduates as a % of total FTE enrollment	80.6	76.9	78.9	80.8	80.4	80.2
Retention rate (%)	94.0	94.1	94.0	95.4	94.7	86.8
Graduation rates (six years) (%)	85.6	86.4	85.5	85.7	86.9	71.0
Financial profile						
Adjusted operating revenue	1,138	1,098	1,087	1,013	1,021	2,148
Adjusted operating expense	1,168	1,102	1,006	958	996	2,031
Net adjusted operating margin (%)†	-2.6	-0.4	8.1	5.7	2.5	3.2
Student dependence (%)	38.1	39.1	39.5	39.8	38.9	37.0
Government operating grant dependence (%)	17.6	17.9	17.9	19.8	17.5	17.3
Endowment and investment income dependence (%)	6.2	7.7	1.2	16.0	5.0	MNR
Cash and investments	2,417	2,452	2,388	2,439	2,050	2,838
Cash & investments to adjusted operating expenses (%)	206.9	222.5	237.5	254.4	205.8	115.3
Outstanding debt	367.9	372.3	376.8	381.1	385.4	1,142.8
Cash & investments to debt (%)	657.0	658.5	633.8	639.8	531.8	278.4
Maximum annual debt service/total operating expense (%)	3.4	3.6	3.9	4.0	3.0	3.4

bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. MNR--Median not reported. †As % of adjusted operating expense. *For 'AA' rated U.S. public colleges and universites. U.S. median figures are in U.S. dollars.

Ratings Score Snapshot

Table 2

Queen's University--Ratings score snapshot

Industry risk	2
Economic fundamentals	1
Market position	1
Management & governance	2
Enterprise risk profile	1
Financial performance	4
Financial resources	1
Debt and contingent liabilities	2
Financial risk profile	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

Queen's University	
Issuer Credit Rating	AA+/Stable/--
Queen's University	
Senior Unsecured	AA+

Certain terms used in this report, particularly certain adjectives used to 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.spglobal.com/ratings for further information. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings.