Research Update:

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

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Overview

- In our view, Queen's University will continue to benefit from an exceptional market position and will maintain solid financial resources and sound operating margins in the next two years.
- We do not anticipate the province's announced plan to cut to domestic tuition fees will affect our assessment of the university's financial profile.
- We are affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on Queen's.
- The ratings reflect our assessment of the university's stand-alone credit profile, which reflects our combined assessment of Queen's extremely strong enterprise and very strong financial profiles.
- The stable outlook reflects our expectations that the university will maintain an exceptional market position and student demand profile, its adjusted operating margins will remain balanced, and its financial resources will remain very robust.

Rating Action

On May 8, 2019, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on Queen's University, in Kingston, Ont. The outlook is stable.

Outlook

The stable outlook reflects our expectations that, within our two-year outlook horizon, Queen's will maintain an exceptional market position and student demand profile, close to balance adjusted net margins, and abundant financial resources. The outlook also reflects our expectation that Queen's relationship with the Province of Ontario will be stable and that our assessment of the likelihood of extraordinary support will not change.

Downside scenario

We could take a negative rating action if, in the next two years, the university's student quality were to deteriorate due to an increase in selectivity ratio to more than 50%, and debt were to increase to a level where cash and investments-to-debt would be lower than 3x. All else being equal, a negative rating action on Ontario would result in a negative rating action on Queen's, given our three-notch cap above the rating on the supporting government. Moreover, a negative government intervention from the province or a significant reduction in the university's resilience to an Ontario default scenario could cause us to lower the ratings.

Upside scenario

All else being equal, a positive rating action during our two-year outlook horizon is unlikely, given our three-notch cap above the rating on the supporting government. In addition, should we upgrade the Province of Ontario, we might not necessarily upgrade Queen's in tandem. This is because of the university's significant operating pressures and reliance on provincial grants, which can be unilaterally altered, with a higher risk of cuts in times of provincial budget stress.

Rationale

The ratings on Queen's reflect the university's stand-alone credit profile (SACP), which S&P Global Ratings assesses at 'aa+' based on Queen's extremely strong enterprise and very strong financial profiles. The ratings also reflect our opinion of a moderately high likelihood that the Ontario government would provide extraordinary support to the university in the event of financial distress. Queen's strong financial resilience and legal and operating independence allow the ratings on the university to exceed those on Ontario under our government-related entities (GRE) criteria.

Established by Royal Charter in 1841, Queen's is a midsize, research-intense university in Kingston that offers a variety of undergraduate and graduate degrees across its six faculties (arts and science, education, engineering, health sciences, law, and business) and two schools (graduate studies and policy studies). It provides leading-edge research in a variety of areas, including computational science and engineering, globalization studies, mental health, biomedical sciences, and energy systems. Queen's is a member of the U15, a group of leading research-intensive universities in Canada. In fiscal 2018, it received and expensed C$148 million in research-related grants and contracts, which have posted an overall increasing trend in the past several years.

The enterprise profile assessment reflects our view of the higher education sector's low industry risk, Queen's solid market position and demand profile, its strong management and governance practices, and Ontario's extremely strong economic fundamentals. We measure the latter with the province's GDP per capita, which we estimate to be about US$45,000 in 2019; good income indicators; and moderate employment and population growth projections.

The university's full-time equivalent students (FTEs) continued to increase in fall 2018, by 3.7% to 25,972, supported by growth in both graduate and undergraduate enrollment. The university will focus its modest enrollment growth efforts on attracting more international students, although competition for these students is high. In our opinion, student quality metrics continue to be strong and compare well with those of rated Canadian peers. This is primarily reflected in Queen's historically high retention and average entry grade rates, which were 94.5% and 89.1%, respectively, in fall 2018. First-year selectivity (offers to applications) and six-year graduation rates remained superior to those of peers, at 38.5% and 85.7%, respectively. Queen's benefits from an exceptional faculty quality, with substantially all faculty members having PhDs or equivalent degrees. We believe Queen's tuition discounting, which we define as total financial aid costs as a percentage of gross tuition and fees, has decreased over the last three years and is lower than that of some rated Canadian peers. It suggests greater flexibility to address affordability concerns, which bolsters the university's competitive position. In our opinion, the university has demonstrated effective fundraising capacity in the past years.

In our view, the Queen's management team's expertise and governance practices, and financial management policies, are strong and has demonstrated consistent operational effectiveness, which we believe lends stability to the credit profile. The university has a five-year strategic plan that guides its long-term strategies based on its mission. Management reviews plan performance annually, tracks progress against specific activity indicators, and monitors identified risks. Queen's has an enterprise risk framework that guides its identification and management of risks. Overall, we view its transparency and disclosure to be good, with policies and procedures in place to adequately mitigate risks. The university conducts its activities according to a three-year operating budget that is aligned with its strategic plan (most recently revised in 2014) and contains what we view as reasonable assumptions. Queen's prepares externally audited financial statements, which have been unqualified, and it has formal policies in place, including investment and debt policies.

In our opinion, Queen´s has a very strong financial profile, with a history of adequate financial performance, excellent levels of available resources, and a moderate debt burden. Its adjusted weighted-average operating margin was 6.9% in the past three fiscal years. Queen´s, along with other Ontario universities, will face increased budget pressure from the government's requirement to cut domestic tuition fees by 10% in fiscal 2020 and freeze it the following year. Queen's estimated an impact of about 3.5% of total revenue, but we believe the university will accommodate these cuts without falling into a deficit position.

Queen's expects to continue to balance its operating budget until fiscal 2022, primarily after drawing down on unit carryforward balances. Although the university does not prepare consolidated forecasts, we expect that, including ancillary operations (which tend to generate positive cash flow), it will maintain consolidated balanced results in the near term. The university has enacted a variety of policy responses to mitigate medium-term financial challenges stemming from the domestic tuition revenue situation, such as modestly expanding its international student recruitment targets and prudently managing expense growth. At the time of our review, Queen's projected a C$3.9 million operating fund surplus in fiscal 2019, below the C$8.3 million budgeted net operating surplus. This was primarily because of one-time salary anomaly payments under the Queen's University Faculty Association collective agreement and renovation costs partially offset by higher international student enrollment. In fiscal 2018, Queen's adjusted operating margin (S&P Global Ratings-calculated) of 8.8% resulted from higher-than-expected student enrolment and efforts to constrain spending.

Similar to that of Canadian peers, the university's limited flexibility to increase its student-generated revenues somewhat offsets its financial performance strength. This is primarily because Ontario monitors and guides domestic tuition rates and student aid (through the tuition framework), and domestic enrollment expansion (through operating grants). However, universities decide these matters and their long-term strategies.

In our view, Queen's has a moderate debt burden. At fiscal year-end 2018, its total gross debt outstanding stood at C$272.2 million. The debt consists of three fixed-rate bullet bonds (representing 79% of total debt) due in 2032 and 2040, and an amortizing bank loan maturing in

2030. As of April 30, 2018, the university held C$89.3 million in sinking funds to repay its three bullet debentures outstanding, which we include in our measure of internally restricted net assets. Queen's maximum annual debt service remained modest, at about 2.8% of 2018 adjusted operating expenditures, which is lower than the median for peers in the 'AA' rating category. Although the university is contemplating new capital projects and dealing with a deferred maintenance backlog of C$297 million in 2018, it has not yet made a decision to fund them with additional debt issuance; however, we expect that Queen's debt metrics will remain adequate in the next two years.

We believe that postemployment liabilities continue to offset Queen's financial profile strengths, despite the steps both the province and university have taken to address the solvency deficit. Queen's maintains a defined contribution pension plan with a defined-benefit component that provides a minimum level of benefits, which is in a deficit and requires ongoing deficit payments, putting some pressure on the university's cash flows. As of the most recent actuarial valuation (Aug. 31, 2017), Queen's estimated its going-concern pension deficit to be C$12 million on a market basis and C$31 million on a smoothed basis, and projected a solvency deficit of C$313 million. Based on these valuations, the university's annual going-concern deficit payments decreased to C$3.4 million in 2018, from C$20.7 million previously. Queen's qualified for temporary solvency funding relief program, under which solvency special payments are $15.6 million. The university took several initiatives to manage its pension deficit, including increased employee contributions. Queen's is continuing to work with the province, the University of Toronto, and the University of Guelph on the creation of a jointly sponsored pension plan (JSPP) for Ontario universities. According to the project´s pipeline, it is expected to be implemented by July 2021. A move to a JSPP, which would not be subject to solvency payment regimes, could help improve Queen's cash flows and provide long-term pension sustainability. It would not eliminate the university's going-concern obligations.

Based on Queen's public disclosures, we do not believe the university has any additional contingent liabilities that could materially affect our view of its credit profile.

Liquidity

In our view, the university has very robust liquidity. At fiscal year-end 2018, total cash and investments increased slightly to C$1.7 billion, from C$1.6 billion in 2017, which is more than 6x the university's debt outstanding.

Unrestricted financial resources available for debt service stood at C$625.35 million, significantly above the previous year's C$582.5 million. This equaled 70.5% of adjusted operating expenses, and covered 229.7% of debt, compared with the previous year's 67.6% and 211.1%, respectively. These ratios compare well with those of peers. We believe that available resources could decline somewhat in the next two years because Queen's will draw on these to fund its capital projects. However, we believe these ratios will remain fairly strong and in line with historical levels in the next two years. In addition, in fiscal 2018, the market value of the university's endowment grew to C$1.1 billion from C$1 billion at fiscal year-end 2017. It is the second-largest endowment among Ontario universities, after the University of Toronto, and it almost doubled since 2009. Queen's has a conservative endowment draw, in our view, with a long-term payout target rate of 4% of the endowment's market value. In fiscal 2018, the endowment paid out C$39.1 million, or about 10% higher than the previous year's spending, reflecting a strong increase in total endowment value.

Moderately high likelihood of extraordinary provincial government support

In accordance with our criteria for GREs, our view of Queen's moderately high likelihood of extraordinary government support reflects our assessment of its 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 one of Canada's most reputable higher education institutions, 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 21% of Queen's 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 measureable 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 its 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.

Ontario elected a new provincial government in June 2018. In January 2019, the government announced changes to university funding, which included a plan to cut domestic tuition fees by 10% for the 2019-2020 fiscal year, a freeze in tuition rates for the following fiscal year, and changes to its student assistance program and some student fees. Furthermore, the province has stated that there will be no additional grant revenue to offset the tuition cut. The university must comply or risk losing some of its core operating grants from the province. We believe that Queen's will avoid consolidated deficits, and will mitigate the loss in tuition revenue through increases in international enrollment and appropriate budgetary adjustments. While the requirement to cut tuition fees was unexpected, it does not change our assessment of the government's likelihood of support based on Queen's strong link and important role with the province.

Queen's University -- Financial Statistics

		--Fiscal year ended April 30--				
	2019 demand data	2018	2017	2016	2015	Medians for 'AA' rated public colleges and universities, 2017
Enrollment and demand						
Headcount	27,516	26,513	25,395	24,802	24,027	MNR
Full-time equivalent	25,972	25,044	23,994	23,575	22,869	34,653
First year acceptance rate (%)	38.5	42.5	43.1	44.9	43.5	66.0
First year matriculation rate (%)	37.8	39.4	40.8	40.5	41.4	MNR
Undergraduates as a % of total enrollment	77.2	77.2	77.6	77.7	77.8	79.2
First-year retention (%)	94.70	94.73	94.73	94.4	94.9	86.0
Graduation rates (six years; %)*	85.7	85.5	85.49	86.3	85.3	MNR

Queen's University -- Financial Statistics (cont.)

	2019 demand data	--Fiscal year ended April 30-- 2018	2017	2016	2015	Medians for 'AA' rated public colleges and universities, 2017
Income statement						
Adjusted operating revenue (C$000s)	N.A.	965,394	884,171	909,786	814,859	MNR
Adjusted operating expense (C$000s)	N.A.	887,398	861,445	828,085	800,502	MNR
Net adjusted operating income (C$000s)	N.A.	77,996	22,726	81,701	14,357	MNR
Net adjusted operating margin (%)	N.A.	8.8	2.6	9.9	1.8	1.22
Provincial grants to revenue (%)§	N.A.	21.4	22.7	21.9	24.2	19.5
Student dependence (%)	N.A.	36.7	36.0	32.1	33.0	42.4
Investment income dependence (%)	N.A.	4.9	9.0	3.3	9.0	1.4
Debt						
Debt outstanding (C$000s)	N.A.	272,239	275,966	279,708	241,354	798,089
Pro-forma debt (C$000s)	N.A.	272,239	275,966	279,708	279,400	MNR
Current debt service burden (%)	N.A.	2.00	2.07	1.88	2.03	MNR
Current MADS burden (%)	N.A.	2.82	2.88	2.99	2.97	3.51
Pro forma MADS burden (%)	N.A.	2.82	2.88	2.99	3.23	MNR
Financial resource ratios						
Endowment market value (C$000s)	N.A.	1,085,486	1,046,531	930,868	918,978	858,805
Cash and investments (C$000s)	N.A.	1,684,575	1,611,055	1,378,323	1,303,432	NMR
Adjusted UFR (C$000s)	N.A.	625,338	582,457	505,866	476,364	MNR
Cash and investments to operations (%)	N.A.	189.8	187.0	166.4	162.8	58.2
Cash and investments to debt (%)	N.A.	618.8	583.8	492.8	540.0	167.8
Cash and investments to pro-forma debt (%)	N.A.	618.8	583.8	492.8	466.5	MNR
Adjusted UFR to operations (%)	N.A.	70.5	67.6	61.1	59.5	34.4
Adjusted UFR to debt (%)	N.A.	229.7	211.1	180.9	197.4	89.7
Adjusted UFR to pro-forma debt (%)	N.A.	229.7	211.1	180.9	170.5	MNR

Queen's University -- Financial Statistics (cont.)

		--Fiscal year ended April 30--				
	2019 demand data	2018	2017	2016	2015	Medians for 'AA' rated public colleges and universities, 2017
Average age of plant (years)	N.A.	17.1	16.4	14.3	13.0	13.1
OPEB liability to total liabilities (%)	N.A.	9.0	8.6	7.7	7.9	MNR

*Median figure is five-year graduation rate. §Median figure is state appropriations to revenue. N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service. OPEB--Other postemployment benefits. UFR--Unrestricted financial resources. Average age of plant = accumulated depreciation/depreciation and amortization expense.

Related Criteria

- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Not-For-Profit Higher Education 2019 Sector Outlook: Credit Pressures Proliferate, Jan. 24, 2019
- Ontario's 10% Domestic Tuition Cut Ratchets Up Pressure On University Budgets, Jan. 21, 2019
- Australia, Canada, Mexico, And U.K. Universities 2018 Medians Report: Increased International Tuition Revenues Preserve The Sector's Stability Amid Stagnant Government Support, Aug. 20, 2018
- U.S. Public College And University Fiscal 2017 Median Ratios: Lower-Rated Entities Continue To Face Financial Stress, July 16, 2018

Ratings List

Ratings Affirmed	
Queen's University	
Issuer Credit Rating	AA+/Stable/--
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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.