STANDARD & POOR'S RATINGS SERVICES
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Queen's University

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Queen's University

Rationale

Issuer Credit Rating
AA+/Stable/--

The ratings on Queen's University, in Kingston, Ont., reflect its stand-alone credit profile (SACP), which Standard & Poor's Ratings Services assesses at 'aa+'. The ratings also reflect our opinion of a "moderately high" likelihood that the Ontario government would provide extraordinary support in the event of financial distress.

The SACP reflects our opinion of the university's strong enrollment and student demand profile, good consolidated budgetary performance, and significant unrestricted financial resources. In our view, Queen's significant-but manageable debt burden and considerable postemployment liabilities offset these strengths somewhat.

In accordance with our criteria for government-related entities, our view of a moderately high likelihood of extraordinary government support reflects our assessment of Queen's important role in the province's public policy, given that postsecondary education is one of Ontario's top priorities in both expenditure and mandate (after health care and school boards), the university's role as one of Canada's most reputable, and its significant research capacity. We believe the provincial oversight, through tuition regulation and targeted grant streams, suggests a strong link with the province. Also supporting our view is that provincial grants account for a significant portion (close to 25%) of the university's consolidated revenue.

We rate Queen's 'AA+' in line with the 'aa+' SACP, which is three notches above that on Ontario, the maximum differential allowed in accordance with our methodology for rating government-related entities 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. We consider the risk of extraordinary negative government intervention to be low, given the university's operational independence, important public policy role, and the government's hands-off approach to the sector.

In our opinion, the university's credit profile benefits from stable demand and enrollment. Queen's full-time equivalent students (FTEs) increased 3.4% to 23,640 FTEs in fall 2015, supported by growth in both graduate and undergraduate enrollment. In our opinion, student quality metrics continued to be strong and compare well with those of rated Canadian peers. The matriculation rate was 40.5%, which we believe is strong and relatively stable. The university's first-year students had an average entry grade of 89.1% for fall 2015, and its offer rate (the ratio of offers to applicants) was low at 44.9%.

Queen's financial performance remained what we consider good in fiscal 2015. The university posted a consolidated surplus of 7.9% of total expenses in fiscal 2015, up from 5.8% in fiscal 2014, by our estimates. Adjusted for noncash items related to changes in the fair value of investments and employee future benefits (but including amortization and depreciation revenues and expenses), the university recorded a modified accrual surplus of 1.8% of adjusted operating expenses, above the 1.5% recorded in the previous year. We expect that, including ancillary operations which tend to generate positive cash flow, Queen's will maintain consolidated surpluses in the next two years. The university's projected enrollment growth, broadening professional programs, and increased focus on revenue diversity primarily support this view.

In fiscal 2015, Queen's debt outstanding amounted to C$241.3 million, up from C$224.7 million a year earlier, reflecting the university's additional C$20 million drawdown under its bank loan. At this level, total debt represented 30.2% of adjusted operating expenses and C$10,554 per FTE, which were slightly higher than those of the previous year and compared with those of most of its domestic peers. Removing the impact of noncash amortization and depreciation revenues and expenses, the adjusted debt service coverage ratio in fiscal 2015 was 3.6x. Debt service burden during the year was a modest 1.9% of adjusted expense. We expect Queen's debt will continue to increase slightly in fiscal 2016, because the university has drawn down the remaining C$40 million under its loan agreement in July and November 2015. Queen's does not have any plans to issue additional debt in fiscal years 2016-2018, so we expect the university's near-term debt metrics to improve.

Queen's faces increasing deferred maintenance requirements, totaling C$253 million in fiscal 2015, or 4.5% higher than the previous year's level. The university will allocate C$7.1 million per year in fiscal years 2016-2018 from its operating budget to cover deferred maintenance costs. Queen's is also expecting its portion of provincial funding to increase in the near term, in light of the province's commitment to supplement its facility renewal funding across the system from fiscal years 2016-2020. In fiscal 2016, the university expects that provincial funding to address deferred maintenance will total C$1.6 million, up from C$1.1 million currently.

We believe Queen's substantial postemployment liabilities constrain the ratings somewhat. At its most recent actuarial valuation (July 1, 2014), the university estimated its going-concern pension deficit to be C$53 million on a market basis and C$175 million on a smoothed basis. Based on these valuations, its going-concern deficit payments will rise to C$20.7 million per in fiscal 2016 (up from C$14.4 million as of the 2011 actuarial valuation). Positive investment returns more than offset lower interest rates and the solvency pension deficit decreased to C$285 million from C$332 million as of the 2011 actuarial valuation. In fiscal 2015, Queen's applied and qualified for the temporary solvency funding relief program under which it has elected to defer solvency deficit payments for three years, to Sept. 1, 2018. We expect greater clarity around the amount and timing of the solvency pension deficit payments after the university formalizes its valuation as of August 2017 (the university currently estimates them at about C$19 million after fiscal 2019). As part of the valuation process, it will be required to submit a plan for funding its deficits.

We have used the "Principles Of Credit Ratings" in conjunction with "USPF Criteria: Higher Education" as our criteria foundation for our analysis of Queen's creditworthiness. We feel that there is a sufficient degree of similarity between U.S. and Canadian public university systems such that we believe the U.S. higher education criteria is an appropriate methodology for evaluating Canadian universities' credit quality.

Liquidity

At fiscal year-end 2015, Queen's consolidated cash and investments totaled C$1.3 billion, up about 17% from fiscal 2014. Total cash and investments represented 162.8% of adjusted operating expenditures, or about 5.4x total debt. Unrestricted financial resources available for debt service stood at C$476.4 million, which was about 12% higher than the previous year's C$425.6 million. This equaled C$20,830 per FTE and 59.5% of adjusted operating expenses, and covered 197.4% of debt. In our opinion, these ratios are strong and compare well with those of the university's peers.

Queen's endowment was C$919 million, up 15% from the previous year. It is the second-largest endowment among Ontario universities, after University of Toronto, and it almost doubled since 2009. The university has a conservative endowment draw, in our view, with a long-term payout target rate of 3.7% of the endowments' market value. In fiscal 2015, the endowments paid out C$30.5 million, or about 8% higher than the previous years' spending, reflecting a strong increase in total endowments' value.

Outlook

The stable outlook reflects our expectations that, in the next two years, Queen's will maintain strong consolidated budgetary performance, its unrestricted financial resources and debt metrics will not materially erode, and that provincial support to the university will not decline beyond our current estimates. The outlook also reflects our expectation that Queen's relationship with the province will be stable.

We could take a negative rating action if the university's budgetary performance were to deteriorate because of lower government grants or a material decline in enrollment, pushing consolidated balances into deficits; or if debt consistently exceeded 35% of adjusted expenses due to an unexpected increase in debt, and its DSCR eroded to less than 3x. A negative rating action on Ontario will also result in a similar rating action on Queen's, given that the university depends on ongoing support from the province, which prevents us from rating it more than three notches above Ontario under our GRE criteria. Moreover, negative government intervention from the province, or a significant reduction in Queen's resilience to an Ontario default scenario as our government-related entity criteria specify could cause us to lower the ratings, potentially to on par with or below that on Ontario, depending on the severity.

We consider the possibility of a positive rating action during our two-year outlook horizon unlikely given our three-notch cap above the rating on the supporting government.

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

In accordance with our criteria for government-related entities, our view of a moderately high likelihood of extraordinary government support reflects our assessment of Queen's important role in the province's public policy, given that postsecondary education is one of Ontario's top priorities and the university's image as one of Canada's most reputable, and its significant research capacity. We believe the provincial oversight, through tuition regulation and targeted grant streams, suggests a strong link with Ontario. Also supporting our view is that provincial grants account for a significant portion (close to 25%) of the university's consolidated revenue.

We rate Queen's 'AA+', in line with the 'aa+' SACP, which is three notches above that on its supporting government. The difference reflects our view of the university's independence from the government and the substantial size of its financial assets. We believe there is a measureable likelihood that Queen's financial resources would be sufficient to meet ongoing operational and debt service requirements should the government default and temporarily suspend payments to the university. In addition, the difference reflects the university's ownership structure, in which the government is neither an owner nor shareholder. We consider the risk of negative government intervention to be low, given Queen's operational independence, its important public policy role, and the government's hands-off approach to the university sector.

Ontario estimated its 2014-2015 deficit at C$10.3 billion and aims to return to a balanced budget in 2017-2018. Although we believe that the province's overall support for universities will remain good, Ontario has imposed some savings targets on the universities. Moreover, in March 2013, the province announced changes to the tuition framework, reducing the cap on annual increases to an average of 3% for undergraduate programs and 5% for professional and graduate programs over the next four years (from a maximum annual average of 5% institution-wide). As well, the government is undertaking a formula funding review in fiscal 2015-2016, which is focusing on student outcomes and institutional differentiation. The SACP on Queen's incorporates the ongoing support from Ontario, and we believe that the province's budgetary constraints and limiting of tuition increases will not materially impact the SACP within the two-year outlook horizon.

Enterprise Profile

Background

Established by Royal Charter in 1841, Queen's is a medium-size, research-intense university in Kingston, Ont., that offers a variety of undergraduate and graduate degrees across its eight faculties (arts and science, education, engineering, health sciences, business, graduate studies and policy studies). The university provides leading-edge research in a variety of areas, including computational science and engineering, globalization studies, mental health, biomedical sciences, and energy systems.

Management

Three bodies including the board of trustees, the senate, and the university council, are responsible for governing Queen's. The university secretariat administers all three.

The board is responsible for overseeing financial matters, administering property, appointing vice-principals, and appointing the principal. It functions through a standing committee structure and is formed of 25 members: three ex-officio and 22 elected, none of them appointed by the province. The senate exercises general control and supervision over academic affairs. The council serves as both an advisory and ambassadorial body to the university as a whole and is responsible for the chancellor's election.

We expect the senior management team to be stable in the next two years. The university prepares externally audited financial statements, which have been unqualified, and operating and capital budget documents are robust and transparent. It approves annually three-year plans for its operating budget and has a number of transparent financial policies in place, including investment and debt policies.

Demand and student quality

In our opinion, Queen's benefits from strong enrollment demand, exceptional student quality, and high matriculation rates, which support its competitive position. It had 23,640 FTEs in fall 2015, up 3.4% from the previous year and 12.2% since fall 2011. This partially reflected graduate expansion efforts, which the university undertook alongside other Ontario universities following the province's promise to fund more graduate spaces. Queen's graduate students accounted for about 18.2% of total enrollment. Management expects applications for fall 2016 to remain strong.

Queen's is a highly selective university with exceptional student quality. The university's first-year students had a high average entry grade of 89.1% for fall 2015. In fall 2015, its first-year undergraduate offer rate (the ratio of offers to applicants) was the lowest of its peers, at 45%, while its ratio of acceptances to applicants was similar to those of its peers at 18%. The matriculation rate was 41%. The fall 2015, six-year graduation rate was what we view as high, at 84%, as was its first year retention rate of 94%.

Although Queen's primarily draws students from Ontario (close to 70%), we think that its domestic and rising international reputation will continue to favorably affect enrollment demand and support greater geographic diversity. In particular, the university has made efforts to attract and support international students by putting in place English-as-a-second-language resources and bridging programs for international students.

Financial Profile

Financial results

In our view, Queen's financial performance remained good in fiscal 2015. The university posted a consolidated surplus of 7.9% of total expenses in fiscal 2015, up from 5.8% in fiscal 2014, by our estimates. Adjusted for noncash items related to changes in the fair value of investments and employee future benefits (but including amortization and depreciation revenues and expenses), the university recorded a modified accrual surplus of 1.8% of adjusted operating expenses, above the 1.5% recorded in the previous year. We expect that, including ancillary operations which tend to generate positive cash flow, the university will maintain consolidated surpluses in the next two years.

Total revenues increased 1.8% in fiscal 2015 on higher student fees, investment income, grants, and contracts. Total government grants increased 2.5%. Government grants are Queen's biggest revenue source, representing 43.0% of total revenues in fiscal 2015, followed by tuition fees, at 31.6%. Ontario operating grants represented 23.1% of the university's 2015 total revenues. The provincial government has capped tuition increases at 3% (for domestic undergraduate students) annually and its own operating deficits will constrain its ability to provide increased support for universities. However, Queen's strategy of increasing international enrollment could boost revenues somewhat, given that tuition rates for international students remain unregulated. On the other hand, we think it is unlikely that provincial operating grants will decline significantly in the next two years, given postsecondary education's vital public role.

In fiscal 2015, Queen's total expenses were fairly stable. Similar to those of rated Canadian peers, salaries and benefits continue to be Queen's biggest source of budgetary pressure and most significant expenditure (they typically represent about 55% of total expenses). They were 1.0% lower in fiscal 2015, reflecting lower financing pension costs as result of strong investment returns, and the departure of a subsidiary of Parteq Innovations (a not-for-profit organization providing Queen's researchers with the business and financial expertise that is needed to advance their discoveries to the public).

Queen's, like all Ontario universities, is facing tight budgetary constraints and lower ongoing government support for operations. Financial pressures have prompted the university to take steps to manage expenses and focus on revenue generation. It adopted the activity-based budget in fiscal 2014, under which income flows directly to the faculties. We expect this to lead some departments to amass reserves in some years and draw them down in others. As such, we expect to see fluctuations in Queen's internally restricted financial assets as departments save and spend. We believe the pressure on internally restricted assets has eased substantially in the previous four years, which will better enable the university to maintain the strong net creditor position that makes it stand out financially from its Canadian peers. Queen's has also introduced three-year budget projections and negotiated changes to salaries and benefits (its largest expense) to mitigate risks to financial results.

The university's budget indicates that Queen's will continue to draw down its reserves to meet shortfalls in its operating fund until fiscal 2017. Its core operating budget typically accounts for 55%-60% of its total expenditures (its other expenditures relate to ancillary, research, consolidated entities, capital, and trust). The university does not prepare consolidated forecasts; rather, it prepares budgets for operations, capital, and ancillary services, the three funds where the university has most discretion in spending.

Capital projects

In fiscal 2015, Queen's total capital expenditures totaled C$52.3 million, down 26.4% from fiscal 2014. The decrease is primarily due to the completion and opening in fiscal 2015 of the Isabel Bader Centre for Performing Arts. Of the 2015 total capital spending, 63% was for building projects and construction in progress, 33% for equipment and furnishing, and 4% for other asset purchases.

Queen's campus master plan, adopted in 2014, guides the university's continued development of campus space and its physical changes in the next 10-15 years. In addition to The Isabel, Queen's recently completed a number of significant capital projects in calendar year 2015, including the reactor materials testing laboratory, a micro and nano research facility, and two new residences (550 beds, and both opened in fall 2015). Queen's major ongoing capital project is the Richardson Stadium revitalization (with a C$20.3 million budget). The university has fundraised more than C$17 million for this, and will fund the rest with cash. Queen's will not begin any capital projects without an acceptable business case and committed funding for both the project's construction and operations.

The university faces growing deferred maintenance requirements, totaling C$253 million in fiscal 2015, or 4.5% higher than the previous year's level. Queen's will allocate C$7.1 million per year in fiscal years 2016-2018 from its operating budget to cover deferred maintenance costs. Queen's is also expecting to see its portion of near-term provincial funding growing, in light of the province's commitment to supplement its facility renewal funding across the system in fiscal years 2016-2020. In fiscal 2016, the university expects that provincial funding to address deferred maintenance will total C$1.6 million, up from C$1.1 million.

Debt

As of fiscal 2015, Queen's had debt outstanding of C$241.3 million, up from C$224.7 million a year earlier, reflecting the university's additional C$20 million drawdown under its bank loan. Total debt includes three fixed-rate bullet bonds (one due in 2032 and two in 2040), an amortizing bank loan to pay for two new residences (maturing in 2030), and a small mortgage. The university holds C$66.7 million in sinking funds to repay its three bullet debentures outstanding. We do not net sinking funds from debt; rather, we include the sinking funds in our measure of internally restricted net assets. Queen's 2016 debt repayment will be C$1.9 million.

The university's total debt represented 30.2% of adjusted operating expenses and C$10,554 per FTE, which were slightly higher than that of the previous year. Removing the impact of noncash amortization and depreciation revenues and expenses, the adjusted debt service coverage ratio in fiscal 2015 was 3.6x. Debt service burden during the year was a modest 1.9% of adjusted expense. These ratios reflect a slightly higher debt burden compared with those of most of Queen's domestic peers.

We expect that Queen's debt will increase slightly in fiscal 2016, because the university has drawn down the remaining C$40 million under its loan agreement in July and November 2015. The loan is floating-rate, which the university converted to fixed-rate via an interest rate swap. The entire bank loan (C$70 million) financed the residencies' construction and residence operations fees will refund it. Queen's does not have any plans to issue additional debt in fiscal years 2016-2018, so we expect its debt metrics to improve in that time.

Pension

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 position and requires ongoing deficit payments putting some pressure on the university's cash flows. As of August 2014, Queen's estimates its going-concern pension deficit to be C$53 million on a market basis and C$175 million on a smoothed basis, and estimates a solvency deficit of C$285 million. Based on these valuations, the university's annual going-concern deficit payments rose to C$20.7 million starting with fiscal 2016 (up from C$14.4 million as of its last actuarial valuation in 2011). In fiscal 2015, Queen's qualified for temporary solvency funding relief program, under which it has elected to defer solvency deficit payments for another three years, to Sept. 1, 2018. We expect greater clarity around the amount and timing of the solvency pension deficit payments after the university formalizes its valuation as of August 2017 (it currently estimates them at about C$19 million after fiscal 2019). As part of the valuation process, Queen's will be required to submit a plan for funding its deficits.

The university took several initiatives to manage its pension deficit, including increased employee contributions (an additional 4.5% pension charge to be budgeted starting September 2015. Queen's is exploring other options for its pension plan, which could include merging the Queen's pension plan with a new jointly sponsored pension plan (JSPP) for Ontario universities. A move to a JSPP, which would not be subject to solvency payment regimes, could help improve Queen's cash flows. It would not eliminate the university's going concern obligations.

Contingent liabilities

Queen's has moderate contingent liabilities that relate primarily to other postemployment benefits. Its 2015 other benefit's plan liabilities are C$74.7 million. Other contingent liabilities include potential litigation payouts, which the university believes would be immaterial, and a small liability for the decommissioning of a joint subatomic physics laboratory.

Financial resources

Queen's endowment was C$919 million, up 15% from the previous year. It is the second-largest endowment among Ontario universities, after University of Toronto, and has almost doubled since 2009. The university has a conservative endowment draw, in our view, with an annual spending rate targeted at about 3.7% of the endowments' market value. In fiscal 2015, the endowments paid out C$30.5 million, or about 8% higher than the previous years' spending, reflecting a strong increase in total endowments' value.

Unrestricted financial resources available for debt service stood at C$476.4 million which was about 12% higher than the previous year's total of C$425.6 million. This equaled C$20,830 per FTE and 59.5% of adjusted operating expenses, and covered 197.4% of debt. In our opinion, these ratios are strong and compare well with those of Queen's peers. At fiscal year-end 2015, consolidated cash and investments totaled C$1.3 billion, up about 17% from fiscal 2014. Total cash and investments represented 162.8% of adjusted operating expenditures, or about 5.4x total debt. The university has a policy of maintaining minimal cash balances with single counterparties.

Queen's manages its pooled endowment fund, pooled investment funds, and sinking funds with different mandates. It manages its pooled investment funds with a slightly more conservative mandate and limits them to Canadian equities, global equities, and fixed income. It has a short-term horizon. The pooled investment fund's annual returns were 10.0% in fiscal 2015, down slightly from 13.5% the previous year but which we still consider strong. Queen's manages the pooled endowment fund with a long-term horizon, and it has some illiquid assets. The endowment fund asset allocation, at April 30, 2015, was 57.3% Canadian and international equities, 33.4% fixed income and absolute return, and 9.3% real assets. The endowment fund's annual return was 12.0%, down from 15.7% the previous year. The university has an investment committee that determines the strategy for the pooled endowment and investment funds, as well as short-term investments and sinking funds.

Fundraising

In October 2015, Queen's 10-year fundraising campaign, which started in 2006, reached C$548.8 million, exceeding its C$500 million goal. The university raised C$71.3 million in 2015. As part of this campaign, the university received a C$50 million donation for its school of business from Stephen J.R. Smith, a Queen's alumnus. This is the largest gift to any school in Canada.

Queen's University -- Peer Comparison

	--Queen's University--		--McGill University--		--University of Western Ontario--	
	2015	**2014**	**2015**	**2014**	**2015**	**2014**
Rating at year-end	AA+/Stable/--	AA+/Stable/--	AA-/Stable/--	AA-/Stable/--	AA/Stable/--	AA/Stable/--
Enrollment and demand						
Headcount	24,027	23,018	39,497	39,349	32,434	31,912
Full-time equivalent (FTE)	22,869	21,899	31,751	32,236	29,966	29,444
Acceptance rate (%)	44	42	32	32	N.A.	51
Matriculation rate (%)	41	41	13	13	N.A.	11
Undergraduate FTEs (as % of total FTEs)	78	78	75	75	79	80

Queen's University -- Peer Comparison (cont.)						
Income statement						
Adjusted operating expenses ($000s)	800,502	795,193	1,167,975	1,138,849	1,061,388	1,044,229
Estimated operating gain (loss) as % of operating expenses	1.8	1.5	4.1	1.5	1.7	5
Tuition and student fee dependence (% of adjusted revenues)	33.0	30.4	21.3	21.2	33.0	30.3
Debt						
Current debt service burden (% of adjusted expenses)	1.9	2.0	0.9	0.9	2.8	2.3
Financial resource ratios						
Cash and investments ($000s)	1,303,432	1,116,892	1,575,218	1,376,609	1,372,329	1,199,212
Adjusted unrestricted financial resources (UFR; $000s)	476,364	425,569	230,248	216,604	560,906	498,898
Cash and investments to adjusted expenses (%)	162.8	140.5	134.9	120.9	129.3	114.8
Cash and investments to debt (%)	540.0	497.1	759.5	713.9	452.1	386.5
Adjusted UFR to adjusted expenses (%)	59.5	53.5	19.7	19.0	52.8	47.8
Adjusted UFR to debt (%)	197.4	189.4	111	112.3	184.8	160.8
Unfunded pension and other postemployment liabilities to total liabilities (%)	10.8	7.0	7.5	8.1	30.3	26.8

N.A.--Not available.

Related Criteria And Research

Related Criteria

- Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Principles Of Credit Ratings, Feb. 16, 2011
- USPF Criteria: Higher Education, June 19, 2007

Ratings Detail (As Of January 22, 2016)	
Queen's University	
Issuer Credit Rating	AA+/Stable/--
Senior Unsecured	AA+
Issuer Credit Ratings History	
14-Dec-2012	AA+/Stable/--
05-Aug-2010	AA+/Negative/--
01-Nov-2002	AA+/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. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.