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Research Update:

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

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Overview

- We are affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on Queen's University.
- The ratings reflect our assessment of the university's stand-alone credit profile, which reflects our combined assessment of the university's extremely strong enterprise and very strong financial profiles.
- The stable outlook reflects our expectations that, in the next two years, Queen's will maintain an exceptional market position and demand, positive adjusted net margins, and abundant financial resources; and the likelihood of extraordinary government support will not change.

Rating Action

On May 25, 2017, 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.

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 the university'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 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 2016, it received C$133 million in research-related grants and contracts, a level that has been fairly stable in the past several years.

We believe the university has an extremely strong enterprise profile.

Supporting our opinion is our assessment of the higher education sector's low industry risk, characterized by counter cyclicality and low competitive risk and growth. In addition, with 66.5% of its students coming from Ontario, the university benefits from excellent economic fundamentals, measured by the province's GDP per capita of US$48,200 in 2015; its good income indicators; and moderate employment and population growth projections.

Queen's excellent market position and student demand also strengthen its enterprise profile. The university's full-time equivalent students (FTEs) continued to increase in fall 2016, by 1.8% to 23,994, supported by growth in both graduate and undergraduate enrollment. 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 of 94.7% and 89.4%, respectively, in fall 2016. First-year selectivity (offers to applications) and six-year graduation rates remained superior to those of peers, at 43.1% and 85.5%, respectively. In our opinion, the university benefits from robust fundraising capabilities, and has consistently exceeded its official campaign and annual fundraising targets in the past years.

Management expertise and governance practices, as well as financial management policies, are strong in our view. Queen's 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. The university has an enterprise risk framework that guides its identification and management of risks. Overall, we view Queen's 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 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, the university has a very strong financial profile, with a history of adequate financial performance, excellent levels of available resources, and a moderate debt burden.

Queen's expects to continue to balance its operating budget until fiscal 2020, 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 surpluses in the near term. Queen's projects a C$3.6 million operating fund surplus in fiscal 2017, well above the C$16.4 million budgeted net operating deficit. This was primarily because of higher student fees from above-target undergraduate enrollment. Together with slight increases in grants, donations, and investment income, these more than offset increased faculties and schools allocations. In fiscal 2016, the university's adjusted operating margin was 9.9%, which was exceptionally high compared with historical levels (closer to 2%), and superior to that of its Canadian and U.S. peer institutions, due to significantly higher income on investments realized during the year. Queen's expects to see this investment income more in line with those realized in past years, so we estimate the impact on its adjusted operating margins will be smoother in the near term.

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 tuition rates and student aid (through the tuition framework), and enrollment expansion (through operating grants).

Queen's total debt stood at C$279.7 million in fiscal 2016. It includes three fixed-rate bullet bonds (representing 77% of total debt), an amortizing bank loan to pay for two new residences (maturing in 2030), and a small mortgage. As of April 30, 2016, the university held C$74.3 million in sinking funds to repay its three bullet debentures outstanding, which we include in our measure of internally restricted net assets. In our view, Queen's debt burden is moderate especially in light of the healthy level of available resources at fiscal year-end 2016, at 180.9% of total pro forma debt. As well, the university's pro forma maximum annual debt service was modest, at about 3.0% of 2016 adjusted operating expenditures. Although Queen's is contemplating new capital projects and dealing with a deferred maintenance backlog of C$235 million in (as per the 2016 Facilities Conditions Audit), it does not expect to fund them with additional debt issuance; therefore, we expect that the university's debt metrics will be stable in the next two years. Queen's received C$36.6 million in federal and provincial grants (from the Post-Secondary Institutions Strategic Investment Fund), which will support two of its in-progress capital projects. We expect donations, internal funding, and savings to cover the remainder of its budgeted capital costs. The university expects total funding for deferred maintenance initiatives to grow to C$10.3 million in fiscal 2018 from C$9.7 million in fiscal 2017, which includes C$2.5 million in provincial funding and C$7.8 million contributions from the operating budget.

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 position and requires ongoing deficit payments, putting some pressure on the university's cash flows. As of the most recent actuarial valuation (Aug. 31, 2014), Queen's estimated its going-concern pension deficit to be C$53 million on a market basis and C$175 million on a smoothed basis, and projected 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. 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. 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. Moreover, Queen's budgets an additional 4.5% employer contribution increase to cover the increased going-concern payments and to create a reserve for pension solvency. The university 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.

Liquidity

In our opinion, Queen's liquidity is exceptional. At fiscal year-end 2016, consolidated cash and investments totaled almost C$1.4 billion, up about 5.7% from fiscal 2015. Total cash and investments represented 4.9x total pro forma debt. Unrestricted financial resources available for debt service stood at C$505.9 million, which was about 6.2% higher than the previous year's C$476.4 million. This equaled 61.1% of adjusted operating expenses, and covered 180.9% of pro forma debt. In our opinion, these ratios are strong and compare well with those of the university's peers.

Queen's endowment was C$930.9 million, up 1.3% from the previous year. 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 2016, the endowment paid out C$33.6 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 the university'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 this view is that the province provides substantial operating grants, which account for a significant portion (20%-25%) of Queen's total revenue.

We believe that the province's overall financial support to universities will remain relatively stable in the near term, given the postsecondary education sector's vital public policy role. Ontario government has made strides in reducing its annual deficit and plans to return to balance in 2017-2018. Under the new grant funding formula, the provincial government is shifting focus toward measurable student outcomes and away from a more enrolment-based formula. It has committed to maintain stable the 2016-2017 funding level for all universities until 2019-2020. Moreover, in December 2016, the province announced it would extend its tuition framework for the next two years, maintaining the annual increases capped to an average of 3% for most undergraduate programs and 5% for professional and graduate programs.

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 to be low, given the university's operational independence, important public policy role, and the government's hands-off approach to the sector.

Outlook

The stable outlook reflects our expectation that, in the next two years, Queen's will maintain an exceptional market position and demand, positive adjusted net margins, and abundant financial resources. We expect its available resources to continue exceeding 35% of adjusted operating expenses and cash and investments to be over 3x total debt; 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 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. 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 GRE criteria specify could cause us to lower the ratings, potentially to on par with or below those on Ontario, depending on the severity.

A positive rating action during our two-year outlook horizon is unlikely given 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.

Queen's University -- Financial Statistics

	--Fiscal year ended April 30--					
	2017	2016	2015	2014	2013	Medians for 'AA' U.S. public colleges & universities, 2015†
Enrollment and demand						
Headcount	25,395	24,802	24,027	23,018	22,465	MNR
Full-time equivalent	23,994	23,575	22,869	21,899	21,412	32,632
First year acceptance rate (%)	43.1	44.9	43.5	41.8	41.2	71.7
First year matriculation rate (%)	40.8	40.5	41.4	40.7	42.6	MNR
Undergraduates as a % of total enrollment (%)	77.6	77.7	77.8	77.5	77.3	77.7
First year retention (%)	94.7	94.4	94.9	94.6	94.4	85.5
Graduation rates (six years) (%)*	85.5	86.3	85.3	86.0	84.1	MNR
Income statement						
Adjusted operating revenue (C$000s)	N.A.	909,786	814,859	806,128	782,858	MNR
Adjusted operating expense (C$000s)	N.A.	828,085	800,502	795,193	776,298	MNR
Net adjusted operating income (C$000s)	N.A.	81,701	14,357	10,935	6,560	MNR
Net adjusted operating margin (%)	N.A.	9.9	1.8	1.4	0.8	2.1
Provincial grants to revenue (%)§	N.A.	21.9	24.2	24.6	24.1	21
Student dependence (%)	N.A.	32.1	33.0	30.3	29.8	42.4
Investment income dependence (%)	N.A.	3.3	9.0	8.1	7.9	0.8
Debt						
Debt outstanding (C$000s)	N.A.	279,708	241,354	224,683	221,074	646,050
Pro-forma debt outstanding (C$000s)	N.A.	279,708	279,400	224,683	221,074	MNR
Current MADS burden (%)	N.A.	2.99	2.97	3.28	3.31	3.70
Pro-forms MADS burden (%)	N.A.	2.99	3.23	3.28	3.36	MNR
Financial resource ratios						
Endowment market value (C$000s)	N.A.	930,868	918,978	800,238	710,251	642,929
Cash and investments (C$000s)	N.A.	1,378,323	1,303,432	1,116,892	977,887	612,539
Adjusted UFR (C$000s)	N.A.	505,866	476,364	425,569	375,928	MNR
Cash and investments to operations (%)	N.A.	166.4	162.8	140.5	126.0	51.7
Cash and investments to debt (%)	N.A.	492.8	540.0	497.1	442.3	162.6
Cash and investments to proforma debt (%)	N.A.	492.8	466.5	497.1	442.3	MNR
Adjusted UFR to operations (%)	N.A.	61.1	59.5	53.5	48.4	30.3
Adjusted UFR to debt (%)	N.A.	180.9	197.4	189.4	170.0	86.7

Queen's University -- Financial Statistics (cont.)						
	--Fiscal year ended April 30--					
	2017	2016	2015	2014	2013	Medians for 'AA' U.S. public colleges & universities, 2015†
Adjusted UFR to pro forma debt (%)	N.A.	180.9	170.5	189.4	170.0	MNR
Average age of plant (years)	N.A.	14.3	13.0	12.2	10.4	12.4
OPEB liability to total liabilities (%)	N.A.	7.7	7.9	7.8	6.9	MNR

Note: Average age of plant equals accumulated depreciation/depreciation and amortization expense.*Median figure is five-year graduation rate. §Median figure is state appropriations to revenue. †U.S. median figures are in U.S. dollars. MADS--Maximum annual debt service. UFR--Unrestricted financial resources. MNR--Median not reported. N.A.--Not available.

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

Ratings List

Ratings Affirmed

Queen's University	
Issuer credit rating	AA+/Stable/--
Senior unsecured debt	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.globalcreditportal.com and at www.spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.