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Queen's University

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Queen's University

Rationale

Issuer Credit Rating
AA+/Stable/--

The 'AA+' 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 demand profile, comprehensive course offerings, significant unrestricted financial resources, good government support, and broadening revenue diversity. In our view, Queen's tight budgetary environment and significant postemployment liabilities offset these strengths somewhat. However, we believe the university made positive changes to its pension plan funding through increased employee contributions and that it is making good progress toward addressing its forecast operating fund deficits. Moreover, we believe it has sizable financial resources it could draw on to meet financial deficits.

Queen's is a medium-size university with comprehensive program offerings (undergraduate and graduate arts and sciences, business, health sciences [including medicine], engineering, and law). It has a steadily increasing student population up 4.6% since the previous year with 23,481 full-time equivalent students (FTEs) in fall 2014.

In our opinion, the university benefits from strong enrollment demand, exceptional student quality, and high matriculation rates, which support its strong enterprise profile. Queen's first-year students had an average entry grade of 89.1% for fall 2014, and its offer rate (the ratio of offers to applicants) was low at 43.5%.

The university's balance sheet gets a boost from its C$425.6 million in unrestricted financial resources, which we calculate as internally restricted financial resources net of invested capital assets and pension liabilities and adding internally restricted endowments. This is one of the highest levels per FTE of its Canadian peers at C$18,962. Queen's unrestricted financial resources are 189.4% of debt outstanding. The university's significant unrestricted financial resources provides it with comparatively more financial flexibility than its peers and are a key credit strength, in our opinion.

Queen's is broadening its revenue diversity by introducing additional professional programs, laddered credentials, and programs to attract and retain international students (whose tuition is not subject to a regulatory cap). It is also offering bridging programs for international students requiring additional English language instruction. Moreover, it is introducing new graduate level programs and certifications.

In our view, offsetting its credit strengths somewhat are increases in legislated pension deficit payments following the solvency payment exemption period, although this likely lies outside our two-year rating horizon. Although Queen's has taken what we consider to be significant measures to mitigate the impact of its unfunded pension liabilities, which have risen to significant levels due to historically low discount rates and turbulent capital markets, they remain sizable. Queen's is making C$14.4 million payments annually in respect of its going-concern deficit, as determined by the university's most recent pension plan valuation filed as of August 2011. It will file its next valuation in the new year based on values as of August 2014, which will determine its going-concern payments starting after filing, and its solvency deficit payments that will start after the solvency exemption period ends as early as September 2015 (although this could be extended three years) are estimated to be C$14 million annually. If Queen's were to face large total pension payments in 2016, which put pressure on financial results and ultimately eroded the university's financial assets significantly, we could revise our outlook to negative. However, we require more clarity on the size and timing of pension payments before taking any rating action.

In accordance with our criteria for government-related entities, 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 top priorities in both expenditure and mandate (after health care and school boards), and there are no viable private alternatives. The province's oversight, program approval rights, and tuition regulation over Queen's suggests a "strong" link with the province, in our judgment.

We have also used the "Principles Of Credit Ratings" in conjunction with "USPF Criteria: Higher Education" as our criteria foundation for our analysis of the university'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 are an appropriate methodology for evaluating Canadian universities' credit quality.

Liquidity

We believe that Queen's exhibits moderate liquidity. It had unrestricted financial resources of about C$425.6 million in 2014, compared with operating expenses of about C$489.3 million or about 87% of operating expenses and 189.4% of debt outstanding. The university has a policy of maintaining minimal cash balances with single counterparties. Queen's invests cash balances in diversified investments to reduce its counterparty exposure. In fiscal 2014, the university had C$84 million cash on its balance sheet. It also had investments of C$1.03 billion.

Outlook

The stable outlook reflects our expectations that Queen's will continue its progress toward balancing its operating budget and not materially erode its unrestricted financial resources or increase its debt level beyond its planned borrowing in respect of two new residences. We also assume the province will not significantly cut the university's funding or substantially alter the sector's tuition-setting regime. We could revise the outlook to negative, all else being equal, if Queen's suffers material setbacks in its efforts to eliminate its budget imbalance, or we come to expect its legislated pension deficit payment obligations will rise significantly and will erode financial assets once the solvency exemption period ends. We consider the possibility of a positive rating action during our two-year outlook horizon unlikely, given the university's tight operating environment.

Rating Methodology: Government Support And Government-Related Entity Criteria

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 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 (although declining) portion of the university's consolidated revenue.

We rate Queen's two 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. The issuer credit rating on Queen's incorporates both the university's SACP combined with our analysis of the moderately high likelihood of extraordinary support from Ontario. The SACP on the university's strong enrollment demand profile, comprehensive course offerings, significant unrestricted financial resources, good government support, and broadening revenue diversity.

Ontario's 2014-2015 budget forecasts a deficit of C$12.5 billion and a return to balance 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). 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 could stress the SACP within the two-year outlook horizon.

Enterprise Profile

University demand and enrollment

Established by Royal Charter in 1841, Queen's is a medium-size university with comprehensive program offerings.

In our opinion, Queen's benefits from strong enrollment demand, exceptional student quality, and high matriculation rates, which support its competitive position. It had 22,443 FTEs in fiscal 2014, up 14.5% since fiscal 2009. 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 17.1% of total enrollment. Preliminary enrollment numbers indicate that FTEs will rise to 23,481 in fiscal 2015, and management expects applications for fall 2016 to be 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 2014. In fall 2013, its first-year undergraduate offer rate (the ratio of offers to applicants) was the lowest of its peers, at 42%, while its ratio of acceptances to applicants was similar to those of its peers at 17%. Matriculation rates were 41%. The 2012-13 graduation rate was what we view as high, at 89% as was its first year retention rate of 95%.

Although Queen's primarily draws students from Ontario, 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.

Management

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

The board is responsible for those aspects of Queen's overall operations which are not assigned to the senate, including overseeing financial matters, administering property, appointing vice-principals, and appointing the principal. The board has 25 members: three ex-officio and 22 elected. It functions through a standing committee structure.

The senate is responsible for determining matters of academic character affecting the university, including student discipline. It has 68 members: 15 ex-officio and 53 elected. It functions through a standing committee structure consisting of 13 committees.

The university council was established in 1874. Alumni elect its members. The council serves as both an advisory and ambassadorial body to the university as a whole and is responsible for the chancellor's election. Although it is not directly involved in operations, the council may bring to the senate or board any matter that it believes affects Queen's well-being and prosperity.

Jim Leech, the former president and CEO of the Ontario Teachers' Pension Plan, began his three year term as chancellor July 1, 2014.

Financial Profile

Queen's, like all Ontario universities, is facing tight budgetary constraints and lower ongoing government support. Financial pressures have prompted the university to take steps to manage expenses and focus on revenue generation. It adopted a new budget model for fiscal 2014, which will allocate revenues and expenses to the academic faculties and schools that generate the revenue. As part of its new budget model, Queen's allocates revenues and expenses to the academic unit responsible for generating them. 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 the university's internally restricted financial assets as departments save and spend. We believe the magnitude of the pressure on internally restricted assets has eased substantially compared with 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 university 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.

After posting deficits in 2009-2012, Queen's had surpluses in 2013 and 2014. In fiscal 2014, the university posted a consolidated C$45.6 million surplus, due to strong returns in its investment portfolios. Although an improvement, Queen's still expects to draw down its reserves to meet shortfalls in its operating fund until fiscal 2016. Its core operating budget typically accounts for 55%-60% of its total university expenditures (its other expenditures relate to ancillary, research, consolidated entities, capital, and trust). Queen's 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.

In fiscal 2014, Queens' revenue growth exceeded growth in expenses again. The university's consolidated revenues increased 4.5% to C$835.4 million. Higher fee income and increased donations spurred the growth. Expenses increased 1.7% to C$789.8 million. Notably, the university limited its increase in salaries and benefits (its largest expense) to 0.2%.

Provincial operating grants and tuition

In 2014, the province implemented a new provincial funding framework for Ontario universities. The framework caps yearly increases for undergraduate tuition fees at 3% (down from 5% under the previous framework) and caps the increases in graduate and professional fees to 5% (from 8%). The framework will be in effect for four years. Other government measures that have negatively affected Queen's along with other Ontario universities, include reductions to the university's base operating grants and reduced grants based on enrollment of full-time international students and new requirements to meet efficiency targets.

In 2014, Queen's received 42.8% of its total revenues from provincial and federal grants. The province primarily supports Ontario universities through operating grants based on a formula applied per FTE. The province and federal government also provide capital grants and fund research. The level of provincial support Queen's received in 2014 continued to fall slightly and remains below the average for the previous 10 years (based on government grants and contracts as a share of total revenues). Ontario has provided support for universities in the province over many years, including through the recession. However, Ontario is facing its own fiscal problems, which has led to declining financial support to the university sector. The government has also provided nonfinancial support in the form of relief for pension solvency deficit funding.

In 2014, the provincial government required all universities to submit a strategic framework to guide and align their strategies and growth with provincial government objectives for higher education. Queen's has submitted a proposal and finalized a strategic mandate agreement with the province.

Financial resources

Queen's has net assets of C$1.05 billion (a C$800.2 million endowment, C$411.0 in internally restricted assets, and an unrestricted deficiency of C$162.1 million). Internally restricted assets include C$236.5 million in invested capital assets. Endowment contributions were C$18.0 million in 2014. The endowment annual spending rate is based on a modification of the Yale method formula. Given current projections, Queen's expects the payout for the next fiscal year to be approximately 3.5%.

The university 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 13.5% in 2014, down slightly from 14.8% 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 is 20% domestic equities, 40% foreign equities, 17% fixed income, 10% private equity, 3% hedge funds, and 10% real assets. The endowment fund's annual return was 15.7%, up from 15.4%% 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 2012, Queen's launched its C$500 million Initiative fundraising campaign. To date, the university estimates that it has reached 87% of the C$500 million goal. Donations were C$39.9 million in 2014.

Liquidity

We believe that Queen's exhibits moderate liquidity. It had unrestricted financial resources of about C$425.6 million in 2014, compared with operating expenses of about C$489.3 million or about 87% of operating expenses and 189.4% of debt outstanding. The university has a policy of maintaining minimal cash balances with single counterparties. Cash balances are invested in diversified investments to reduce Queen's counterparty exposure. In fiscal 2014, the university had C$84 million cash on its balance sheet. It also had investments of C$1.03 billion.

Debt

As of fiscal 2014, Queen's had debt outstanding of C$224.7 million, up from C$221.1 million a year earlier. This includes three bullet bonds (one due in 2032 and two in 2040), one amortizing bond (maturing in 2014), a new amortizing bank loan to pay for two new residences (maturing in 2030), and a small mortgage. Since the publication of its financial statements, Queen's has repaid the amortizing bond due in July 2014. The university holds C$49.1 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 2015 debt repayment will be C$3.4 million.

In 2014, the university began borrowing via a bank loan to finance the construction of two new residences that will support enrollment growth. The new residences will have 550 beds and will open for fall 2015. We expect they will cost about C$63 million. Queen's will draw down under its loan agreement until November 2015. The loan is floating-rate, which the university converted to fixed-rate via an interest rate swap.

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 2013, Queen's estimates its going-concern deficit to be C$108 million on a market basis and C$164 million on a smoothed basis, and estimates a solvency deficit of C$292 million. Based on these valuations, the university's going-concern deficit payments would rise to C$19.2 million (up from C$14.4 million) and its solvency payments would be C$16.0 million. These figures are unchanged from our previous report; however, they could when Queen's files it next pension plan valuation (as of August 2014). The solvency payment estimates are based on a 10-year solvency deficit amortization period, which the government may grant to the university as stage 2 solvency relief. If granted, this would extend the solvency payment time frame from the current five years. The government has introduced legislation that would extend the solvency payment exemption for an additional three years, and require the deficit to be amortized over seven. We expect greater clarity around the amount and timing of the pension deficit payments after Queen's formalizes its valuation as of August 2014. As part of the valuation process, the university will be required to submit a plan for funding its deficits.

Queen's is exploring other options for its pension plan, which could include merging the Queen's pension plan with Colleges of Applied Arts and Technology Pension Plan, the jointly sponsored pension plan (JSPP) for colleges. The government of Ontario is encouraging universities to move to a JSPP, but has not established a legislative framework to allow universities to establish their own version on the JSPP. 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.

Capital projects

In 2014, Queen's adopted a new campus master plan that will guide the university's continued development of campus space. This framework will guide the campus' physical changes in the next 10-15 years. Queen's recently completed a number of significant capital projects in 2014, including the Isabel Bader Centre for Performing Arts, the reactor materials testing laboratory, and a micro/nano research facility. Ongoing capital projects include the two new residences. Capital expenditures were C$71 million in fiscal 2014. Queen's will not begin any capital projects without an acceptable business case and committed funding for both the construction and operations of the new project.

The university faces moderate deferred maintenance requirements. It estimates its deferred maintenance is C$242 million. The province has provided funding of C$1 million to address deferred maintenance.

Contingent liabilities

Queen's has moderate contingent liabilities that relate primarily to other postemployment benefits. Its 2014 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.

Queen's University -- Peer Comparison

	--Queen's University--		**--McGill University--**		**--University of Western Ontario--**	
	2014	**2013**	**2014**	**2013**	**2014**	**2013**
Issuer credit rating	AA+/Stable/--	AA+/Stable/--	AA-/Stable/--	AA-/Stable/--	AA/Stable/--	AA/Stable/--
Enrollment and demand						
Headcount	24,777	24,042	39,349	38,779	37,835	36,531
Full-time equivalent (FTE)	22,443	21,904	31,560	31,197	30,482	29,039
Acceptance rate (%)	42	41	45	43	54	54
Matriculation rate (%)	41	43	45	43	54	54
Undergraduate FTEs as % of total FTEs	83	82	75	75	80	80
Income statement						
Adjusted operating revenues ($000s)	835,410	799,164	1,166,470	1,141,043	1,096,838	1,049,744
Adjusted operating expenses ($000s)	789,823	776,215	1,138,850	1,129,216	1,044,229	987,065
Estimated operating gain/loss as % of operating expenses	5.8	2.9	2.4	1.0	5.0	6.4
Tuition and student fee dependence (% of adjusted revenues)	29.4	29.8	21.0	20.0	30.3	29.4

Queen's University -- Peer Comparison (cont.)						
Debt						
Debt outstanding ($000s)	224,683	221,074	193,020	199,683	310,290	316,185
Current debt service burden (% of adjusted expenses)	2.0	2.4	0.9	0.9	2.3	2.4
Financial resource ratios						
Total endowment ($000s)	800,238	710,251	1,282,392	1,089,182	509,659	431,853
Cash and investments ($000s)	1,116,892	977,887	1,376,609	1,172,379	1,199,212	1,074,178
Adjusted unrestricted financial resources (UFR; $000s)	425,569	375,928	216,604	166,513	496,213	391,981
Cash and investments to adjusted expenses (%)	141.4	126.0	120.9	103.8	114.8	108.8
Cash and investments to debt (%)	497.1	442.3	713.2	587.1	386.5	339.7
Adjusted UFR to adjusted expenses (%)	53.9	48.4	19.0	14.7	47.5	39.7
Adjusted UFR to debt (%)	189.4	170.1	112.2	83.4	159.9	124
Unfunded pension and other postemployment benefit liabilities to total liabilities (%)	7.1	14.5	8.2	9.1	26.0	24.4

Related Criteria And Research

Related Criteria

- Principles Of Credit Ratings, Feb. 16, 2011
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010
- USPF Criteria: Higher Education, June 19, 2007

Ratings Detail (As Of January 7, 2015)	
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.