S&P Global Ratings

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Research Update:

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

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Overview

- Queen's University's enrollment remained strong despite the COVID-19 pandemic-related restrictions, supported by exceptional student demand characteristics and market position.
- Although risks related to prolonged pandemic restrictions and rising inflation remain present, we expect the university will maintain a very strong financial profile, largely fueled by enrollment growth, helping to internally finance its capital plans and maintain a moderate debt burden.
- Therefore, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on Queen's and maintained the stable outlook.

Rating Action

On April 13, 2022, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on Queen's University, in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects our view that, over our two-year outlook horizon, Queen's will maintain an exceptional market position and student demand profile, positive adjusted net margins, and abundant financial resources, and will not increase its debt burden. 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 lower the ratings if significantly lower enrollment or unmanaged inflationary pressures resulted in lower-than-expected operating margins in the next two years, potentially requiring Queen's to rely on its substantial liquidity position to help fund operations and debt service. Should this cause the university's cash and investments to fall below 3x its debt outstanding on a sustained basis, we could lower the ratings. All else being equal, a negative rating action on Ontario would also 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. However, even if we were to raise the rating on the Province of Ontario, we might not necessarily raise the rating on Queen's in tandem. This is due to the university's significant operating pressures and reliance on provincial grants, which can be unilaterally altered and have 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. We believe that the university's robust cash and investments, which cover over 3x its total debt, strengthen the SACP; however, we believe that the limited financial flexibility resulting from provincially capped tuition rates and higher dependence on government funding and student revenues compared with that of U.S. 'AAA' rated peers offset this strength (of note, there are no 'AAA' rated universities in Canada). 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.

Although the pandemic has disrupted Queen's operations in the past two years, the related impact on its overall financial performance has been fairly muted in comparison. We believe that healthy student demand and very robust liquidity will help to offset losses in ancillary operations and maintain the university's credit metrics in the next several years despite lingering risks from the protracted pandemic.

Queen's was established in Kingston, Ont., by Royal Charter in 1841. It is a midsize, research-intensive university offering a variety of undergraduate and graduate degrees across six faculties (arts and science, education, engineering, health sciences, law, and business) and two schools (graduate studies and policy studies). Queen's undertakes cutting-edge research in many fields, including applied artificial intelligence and analytics, particle astrophysics, cancer clinical trials, clean technology, geotechnical engineering, surveillance studies, and art conservation.

The university is a member of the U15, an association of leading public Canadian research universities. Members undertake 80% of all competitive university research in the country, and rank among the world's premier institutions. Queen's external research funding was C$182 million in fiscal 2021, virtually unchanged from the previous year; it increased about 21% in the past five 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, and strong management and governance practices; and Ontario's extremely strong economic fundamentals. In the past three years, an average of 63% of the student body originated from Ontario; therefore, we measure the economic fundamentals based on the province's GDP per capita (estimated at about US$54,800 in 2022), good income indicators, and moderate employment and population growth projections.

In our opinion, student quality metrics continue to demonstrate strength and compare well with those of rated Canadian peers. The university's full-time equivalent (FTEs) students increased by 7% in fall 2021, continuing a steady upward trend and supported primarily by 17.4% growth in graduate enrollments, while undergraduate FTEs were 4.9% higher. As do many other universities worldwide, Queen's will continue to focus its enrollment growth efforts on attracting more international students; in autumn 2021, approximately 13.5% of FTEs were from outside of Canada, slightly up from 13% in 2020. We expect enrollment growth will remain modest in the near term.

Queen's benefits from exceptional faculty quality, with substantially all faculty members possessing terminal degrees (PhDs or equivalents), a trend consistent over at least the past five years. Moreover, its retention rate in fall 2021 remained very strong, at 94%; the retention rate is one of the highest among Canadian peers. First-year selectivity (offers to applications) and six-year graduation rates remained higher than those of most peers, at 41.5% and 85.5%, respectively. Queen's tuition discounting, which we define as total financial aid costs as a percentage of gross tuition and fees, has increased slightly in the past three years. This suggests that, although more limited, the university has some flexibility to address affordability concerns, bolstering its competitive position. In our opinion, the university has demonstrated effective fundraising capacity, raising between C$60 million-C$70 million annually in the past few years.

Queen's management team's expertise, governance practices, and financial management policies, in our view, are strong. Management has demonstrated consistently positive operational effectiveness, which we believe lends stability to the credit profile. The university follows 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. Moreover, it has a robust universitywide enterprise risk framework that guides its identification and management of risks. Overall, we view 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. It prepares externally audited financial statements, which are unqualified, and has formal policies in place, including investment and debt policies.

In our view, 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. We expect the university to maintain, on average, positive adjusted net margins supported by strong enrollment and effective management of the operating pressures it faces--primarily the tuition framework, flattening government grants, decreased ancillary revenues, and rising expenditures. At the end of the second quarter of fiscal 2022, Queen's projected an operating deficit of approximately C$23.1 million, below the originally budgeted C$40.1 million. This was primarily due to savings from postponed hiring and renovation projects at the faculties' level, which partly offset shortfalls in key revenue streams such as international undergraduate student tuition, and other revenues. At the same time, due to reduced residence, events, and other ancillary operations, it estimates the ancillary deficit will be C$3.1 million, in line with the budget. Although the pandemic could continue to weigh on ancillary operations, potentially weakening consolidated financial performance in the near term, we believe Queen's can gradually reverse the trend once the pandemic-related restrictions ease. On average from 2019-2021, the university generated an adjusted net operating margin (on a fully consolidated basis) of 5.1% of adjusted operating expenditures, which is slightly below the 5.8% average recorded last year. The decrease is primarily attributed to the 2020 operating margin, which was more in line with historical levels and below the exceptional levels recorded in 2018 and 2019 when the university's financial results benefited from high investment returns and donations and higher-than-anticipated student enrollment.

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 enrolment 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 2021, its total gross debt outstanding was C$385 million. The debt consists of four fixed-rate bullet bonds due at the earliest in fiscal 2033, and an amortizing bank loan maturing in fiscal 2031. The university issued its most recent bullet debentures in April 2020; proceeds will be used to build a 334-bed student residence, to renovate the 355 King Street West site for administrative purposes, and for the expansion of Duncan McArthur Hall for academic purposes. As of April 30, 2021, the university held approximately C$120 million in sinking funds to repay its bullet debentures outstanding, which we include in our measure of internally restricted net assets. Queen's maximum annual debt service remained modest, at about 4.1% of 2021 adjusted operating expenditures.

We believe that available resources could decline somewhat in the next two years if Queen's uses reserves to meet any financial shortfalls from the COVID-19 pandemic or capital projects over the next two years. However, we believe these ratios will remain fairly strong, on average, in line with historical levels.

As of July 1, 2021, Queen's, together with the University of Toronto and the University of Guelph, transferred its assets into the newly created university pension plan (UPP) for Ontario universities. The UPP is designed to enhance the long-term sustainability of defined-benefit pension plans in the university sector. This means that, while participating universities will continue to make special contributions to eliminate their own past service going-concern deficits, they will not be subject to solvency payment regimes. Queen's expects it will not need to keep making past service payments, given its going-concern surplus of C$132 million at a new actuarial valuation in 2021 based on UPP's assumptions. This will help improve cash flows and provide long-term pension sustainability.

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, supported by exceptional investment performances. At fiscal year-end 2021, total cash and investments increased to C$2.4 billion from C$2.0 billion in 2020, which is 6.3x the university's debt outstanding. Unrestricted financial resources totaled C$867 million, up from C$734 million in 2020. This covers approximately 90% of adjusted operating expenses and 225% of debt. These ratios compare well with those of peers. We expect that Queen's debt metrics will remain adequate in the next two years. We believe that balance sheet and liquid resources will help the institution to offset medium-term pressures that might arise.

In fiscal 2021, the market value of the university's endowment was C$1.4 billion, up from C$1.1 billion in the previous year. This is one of the largest endowments among Canadian universities, and the second largest in Ontario after the University of Toronto's; since 2009, Queen's endowment's market value has more than doubled. The university has a conservative endowment draw, with a long-term payout target rate of 4% of the endowment's market value. In fiscal 2021, the endowment paid out C$47.6 million, a payout 7% higher than the previous year's spending.

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 20% 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 measurable likelihood that Queen's financial resources would meet ongoing operational and debt service requirements should the government default and temporarily suspend payments to the university. In addition, the difference reflects Queen's ownership structure, in which the government is neither an owner nor shareholder. Moreover, the province appoints none of the university's board of trustees' members. We consider the risk of extraordinary negative government intervention low, given the university's operational independence, important public policy role, and the government's hands-off approach to the sector.

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 2020-2021 and 2021-2022. The freeze has been extended to 2022-2023, with the ability to increase fees for domestic out of province students by up to 5%. Furthermore, the province did not provide additional grant revenue to offset the tuition cut. Neither the federal nor provincial government has provided material direct financial support for universities to offset impacts stemming from the COVID-19 pandemic, although the federal government introduced an emergency income support program for students in 2021 and has increased its grant programs, which help mitigate affordability concerns. Although we are not expecting any material increase in ongoing operating or capital funding from the province in the medium term, we continue to believe that there is a moderately high likelihood that the province would provide support to Queen's in a distress scenario.

Environmental, social, and governance

In our view, higher education entities face elevated social risk due to uncertainty over the duration of the COVID-19 pandemic, and its uncertain effect on enrollment levels, campus activities, and mode of instruction. We view the risks posed by COVID-19 to public health and safety as a social risk under our environmental, social, and governance (ESG) factors. Despite the elevated social risk, we believe Queen's environment and governance risk are in line with our view of the sector as a whole.

Key Statistics

Queen's University -- Enterprise And Financial Statistics

	Demand data 2022	--Fiscal year ended April 30-- 2021	2020	2019	2018	Medians for 'AA' U.S. public colleges & universities, 2020†
Enrollment and demand						
Headcount	31,573	29,509	28,358	27,516	26,513	MNR
Full-time equivalent	29,207	27,295	26,638	25,972	25,044	38,513
First year acceptance rate (%)	41.5	47.5	38.2	39.4	44.2	68.9
First year matriculation rate (%)	33.8	34.6	34.0	33.5	35.5	MNR
Undergraduates as a % of total enrollment (%)	75.4	77.1	76.7	77.2	77.2	78.7
First year retention (%)	94.0	95.4	94.7	94.5	94.7	86.7
Graduation rates (six years) (%)*	85.5	85.7	86.9	86.4	85.5	MNR
Income statement						
Adjusted operating revenue (C$000s)	N.A.	1,012,821	1,020,592	1,052,480	965,394	MNR
Adjusted operating expense (C$000s)	N.A.	958,448	995,689	970,467	887,398	MNR
Net adjusted operating income (C$000s)	N.A.	54,373	24,903	82,013	77,996	MNR
Net adjusted operating margin (%)	N.A.	5.7	2.5	8.5	8.8	0.80
Provincial grants to revenue (%)§	N.A.	20.5	20.5	19.7	21.4	19.3
Student dependence (%)	N.A.	39.8	38.9	37.2	36.7	40.0
Investment income dependence (%)	N.A.	16.0	5.0	7.1	4.9	1.3
Debt						
Debt outstanding (C$000s)	N.A.	385,354	389,437	268,397	272,239	1,021,735
Current debt service burden (%)	N.A.	2.24	1.80	1.84	2.00	MNR
Current MADS burden (%)	N.A.	4.06	3.91	3.00	2.82	3.30
Financial resource ratios						
Endowment market value (C$000s)	N.A.	1,393,708	1,141,352	1,152,622	1,085,486	MNR
Cash and investments (C$000s)	N.A.	2,438,735	2,049,579	1,843,276	1,684,575	MNR
Adjusted UFR (C$000s)	N.A.	866,852	734,103	712,463	625,338	MNR

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

		--Fiscal year ended April 30--				
	Demand data 2022	2021	2020	2019	2018	Medians for 'AA' U.S. public colleges & universities, 2020†
Cash and investments to operations (%)	N.A.	254.4	205.8	189.9	189.8	53.0
Cash and investments to debt (%)	N.A.	632.9	526.3	686.8	618.8	167.7
Adjusted UFR to operations (%)	N.A.	90.4	73.7	73.4	70.5	36.2
Adjusted UFR to debt (%)	N.A.	224.9	188.5	265.5	229.7	104.9
Average age of plant (years)	N.A.	17.7	16.9	16.4	17.1	13.6
OPEB liability to total liabilities (%)	N.A.	7.7	7.3	8.3	9.0	MNR

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

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Outlook For Global Not-For-Profit Higher Education: Out Of The Woods, But Not Yet In The Clear, Jan. 20, 2022
- Australia, Canada, Mexico, And U.K. Universities Medians Report: Credit Metrics Remain Largely Stable Through Persistent Headwinds, June 30, 2021
- U.S. Not-For-Profit Public College And University Fiscal 2020 Median Ratios: The Pandemic Presents New Challenges In An Increasingly Competitive Landscape, June 23, 2021

Ratings List

Ratings Affirmed

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