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McMaster University

Primary Credit Analyst:
Stephen Ogilvie, Toronto (1) 416-507-2524; stephen_ogilvie@standardandpoors.com

Secondary Contact:
Jennifer Love, Toronto (1) 416-507-3285; jennifer_love@standardandpoors.com

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Rationale

Issuer Credit Rating
AA-/Stable/--

The ratings reflect Standard & Poor's opinion of the following factors:

- McMaster's strong demand and research profiles, due to its broad range of program offerings, high research intensity, and close proximity to the Greater Toronto Area. Its enrolment was 25,399 full-time equivalent students (FTEs) in fiscal 2011 (year ended April 30, 2011), exceeding fiscal 2010's enrollment by about 1%. Among the university's key strategic priorities is increasing graduate enrolment, which rose about 8% in fiscal 2011. This complements the province's goal of adding 3,300 new graduate spaces provincewide by 2012 and supports the university's strong research profile. McMaster ranked second in Canada for research intensity (sponsored research income per full-time faculty) in a 2010 Infosource Inc. report;
- Sound government funding support. Senior government grants account for a significant portion (47%) of the university's revenues, which help underpin the ratings. In addition to a base operating grant (which it provides on a weighted student enrolment basis), the Province of Ontario (AA-/Negative/A-1+) also has a history of providing additional grant envelopes, or one-time year-end disbursements for alleviating operating and capital pressures. Given Ontario's large deficit, however, its medium-term financial support for universities could be constrained; and
- Prudent debt management and a moderate debt burden. McMaster's debt was C$165.6 million or C$6,517 per FTE at April 30, 2011. In addition, the university has guaranteed up to C$22 million of the long-term debt for the First Longwood Innovation Trust. It has steadily reduced its debt stock in every year but one since going to market with its first and only debenture issue in September 2002. McMaster has a relatively low debt burden compared with its rated peers; only York University (AA-/Stable/--) had a smaller one. In addition, the university has established its own debt-monitoring policy to guide financial planning, internally financed its capital projects, and created voluntary debt retirement funds for its debenture and mortgages.

We believe the following factors constrain these strengths:

- McMaster, like all rated Canadian universities, has been subject to a tight operating environment. Despite posting a consolidated operating surplus of C$22 million (or 2.6% of revenues) in fiscal 2011, the budget has been strained and McMaster would have posted a deficit without one-time year-end government grants. While the 2.6% surplus in fiscal 2011 was an improvement on fiscal 2010's 1.4% surplus and fiscal 2009's negative 7.4% deficit, the university is forecasting a near-breakeven result in fiscal 2012;

- Potential postemployment deficit funding. In fiscal 2011, McMaster's pension assets continued their rebound from the recession; however, a large unfunded liability position remains. The university estimated it had a liability of C$211 million in its registered pension plans at April 30, 2011, an improvement from the previous year. It was required to file an actuarial valuation report as of July 2011, which determined its special pension deficit payments for the next three years. McMaster will face considerable special payments of about C$10.4 million in fiscal 2012, and $21.0 million per year in each of the next three years, compared with C$8.4 million in fiscal 2011. These payments are down from previous estimates, because the university has qualified for temporary solvency relief; and
- McMaster's low unrestricted financial resources (internally restricted endowment plus internally restricted net assets). After falling three years in a row, the university's unrestricted financial resources rose to C$121.2 million, or C$4,774 per FTE, in fiscal 2011; however, they remain well below their highest levels at C$235.9 million, or C$10,299 per FTE, in fiscal 2007.The university's decision to use its internal resources to fund some one-time operating costs (going-concern pension deficit and early retirement program in fiscal 2008) helped fuel this decline. Its unrestricted financial resources are likely to remain under pressure in the near term, reflecting continued internal financing of loans for capital projects. While this has kept debt at a relatively low level, financial flexibility has diminished considerably and, in our view, is not likely to dramatically improve in the next few years.

Outlook

The stable outlook reflects our expectation that McMaster will build on its progress in 2011 by continuing to improve its operating performance in the next two years while maintaining its unrestricted financial resources. Furthermore, we assume the province will not significantly cut the university's funding without providing greater tuition-setting flexibility. Standard & Poor's could lower the ratings if these assumptions are not met, or if we downgrade the province. Conversely, we could raise the ratings if McMaster's unrestricted financial resources rise to their former levels and debt remains relatively low.

Government-Related Entity Methodology

In accordance with our criteria for government-related entities, our view of a "moderately high" likelihood of extraordinary government support reflects our assessment of McMaster's "important" role in the province, given that postsecondary education is the top of Ontario's priorities in both expenditure and mandate after health care and primary and secondary education. The assessment also reflects our view of the university's strong reputation in the country and its significant research capacity. In our opinion, the provincial oversight and directive McMaster receives through tuition regulation and program approval suggests a "strong" link with Ontario. Also supporting this view is that provincial operating grants account for a material portion of the university's operating revenues.

Our government-related entity analysis incorporates our opinion of Ontario ongoing financial support as well as McMaster's public policy role. Grants from senior levels of government account for 47% of McMaster's total revenues. The province's large operating deficits have reduced its budgetary flexibility, and we expect financial support for universities could be constrained in the medium term. Nevertheless, we believe that Ontario will continue to provide solid financial support to universities and we expect that postsecondary education will continue to play a vital public policy role.

Background

Founded in 1887, McMaster is a research-intense, doctoral university in Hamilton, the fifth-largest city in Ontario. McMaster has 25,929 FTEs as of fall 2011, and is the fourth-largest of 20 public universities in the province. McMaster is a well-regarded research university and was ranked as one of Canada's top research universities (second place in a 2010 Infosource Inc. report). Moreover, McMaster has garnered international attention, placing fourth in Canada and within the top 100 universities internationally in the Times Higher Education rankings.

Strong Enrollment Growth

McMaster continues to benefit from a strong enrollment demand profile. The university's fall 2011 (fiscal 2012) FTE enrollment was 25,929, up 2% from the previous year. Its enrollment growth has moderated since fall 2009, following a period of sustained annual high increases since fall 2001, due to the double cohort, demographics, and rising participation rates. This recent moderation is in keeping with McMaster's plans to manage undergraduate enrollment growth and raise graduate enrollment. From fiscal years 2008-2012, enrollment growth at the graduate level was 23.0%, and 8.4% at the undergraduate level. McMaster aims to have graduate students eventually make up 20% of total enrollment, from 16% in fiscal 2012. This complements the province's own objective of adding up to 3,300 new graduate student spaces across Ontario by 2012. The government is accommodating the new spaces with operating and capital funding.

At the undergraduate level, one of McMaster's priorities is to enhance these students' experience through greater engagement. This initiative should enhance McMaster's already strong and stable demand metrics, in our view. Its selectivity (offers divided by applicants) was 63% in the falls of 2010 and 2011, and its yield (registrants/applicants) was 16% in those years. We expect enrolment demand and selectivity to remain strong. Across all Ontario, the province projects postsecondary education enrollment to increase at a moderate 1.7% annually from fiscal years 2012-2013 through 2017-2018, a rate we view as healthy.

The Ontario government announced in its 2011 budget that it would allocate funding for 60,000 new postsecondary spaces over five years (19,000 for colleges and 41,000 for universities). Beginning in January 2012, the province introduced a tuition rebate program that returns 30%, or C$1,600, of tuition to university students with household income of less than C$160,000 per year.

Operating Performance: Improvement Has Continued

McMaster's operating performance has improved since fiscal 2009, when global capital market weakness trimmed the university's assets and turned the surpluses of previous years into deficits. In fiscal 2011, it had a full accrual surplus of C$22 million, or 2.6% of revenues. After adjusting for earned capital contributions and amortization, its surplus stood at C$12.4 million. Revenue growth at 4.1% in fiscal 2011 outpaced that of expenditures, at 2.9%. Operating grants from the provincial government, McMaster's largest revenue source at about 27% of total revenues, increased C$10 million, or 4.5% from fiscal 2010, stemming from quality agreement, undergraduate accessibility, and graduate expansion funding envelopes. Tuition, which represented 19.5% of revenues in fiscal 2011, increased C$12.8 million, or 8.3%. Investment income lifted the university's revenues C$40.3 million, although this was about 17% lower than the previous year. Investment income on endowment funds generally boosts operating results; however, it can also make them volatile, as the fiscal 2009 operating deficit illustrated. McMaster's largest expense is salaries and benefits, accounting for 63% of expenditures, and in the past five years they have grown 5.5% annually. The university is complying with the province's Compensation Restraint Act legislation.

While McMaster has made some progress in strengthening its operating results in fiscal 2011, we would note that its budget remains under pressure and the university is forecasting a near-breakeven result in fiscal 2012.

Governance Changes: New President

On July 1, 2010, Dr. Patrick Deane became McMaster's seventh president, for a five-year term. He has a proven track record as a senior university administrator. Standard & Poor's does not expect the new president to dramatically shift McMaster's vision or strategic policy in a way that might adversely affect the ratings. His priorities for the university are to develop a distinct, effective and sustainable undergraduate experience, enhance the connections between McMaster and the community, and continue to support research that integrates with its educational mission.

Endowment Has Returned To Precrisis Levels

In fiscal 2011, McMaster's endowments increased to $513 million, which marks the restoration of endowment capital to preglobal-crisis levels. The university recognized investment income of C$40 million and added C$23 million directly to the endowments. Total endowments per FTE rose to C$20,201 in fiscal 2011 from C$18,425 the previous year. However, the university's unrestricted financial assets remain low, in our view, at C$121.2 million, or C$4,774 per FTE, in fiscal 2011, well below their highest levels at C$235.9 million, or C$10,299 per FTE, in fiscal 2007.

In addition, McMaster received a large donation this year of C$30 million for stem cell therapies and one-stop patient care.

No New Debt Expected

In fiscal 2011, McMaster's debt, which includes long-term debt and a guarantee totaling to C$174 million, represented C$6,856 per full-time equivalent and 21.1% of adjusted revenues (Standard & Poor's-calculated). The university's debt service coverage ratio fell to 2.6x in fiscal 2011 slightly below the average of its peers at 2.9x, and down from a sound 4.3x in fiscal 2010. We attribute the fall to McMaster's repayment of a residence mortgage, which increased the current portion of debt due and decreased the ratio. The university forecasts its fiscal 2012 debt and financing charges will be C$10.6 million, almost 2% of its forecast expenditures for the year.

As of April 30, 2011, McMaster had C$152.1 million of long-term debt, including C$120 million of debentures with principal repayment in 2052. It also included a residence mortgage (C$11.5 million), which the university repaid in full on May 1, 2011; and two bank loans and another mortgage, the three of which totaled to $20.6 million. McMaster has also guaranteed the debt service obligations of its research park (The First Longwood Innovation Trust) up to C$23 million--the value of the guarantee as of the end of April 2011, was C$22.0 million. Debt outstanding was little changed in 2011. The university has indicated that it does not expect to issue further debt.

McMaster also has two other long-term obligations, the decommissioning of its nuclear reactor and two interest rate swap agreements, which total C$13.4 million. The decommissioning obligation, which was valued at C$8.0 million at the end of April 2011, is largely offset by trust funds of C$7.2 million accumulated for this purpose.

The university's practice of establishing off-setting sinking funds diminishes its debt burden somewhat, including one sinking fund set up to repay the outstanding bond issue (valued at C$10.8 million at fiscal year-end). Payments to the sinking funds are voluntary. Accordingly, we include the sinking funds in internally restricted net assets, but do not consider them in our calculation of its debt burden.

Capital priorities for fiscal 2012 include the McMaster Automotive Resource Centre (C$21.6 million) and the Centre for Primary Care (C$84.6 million approved by the board in the spring of 2012). In fiscal 2012, the university is forecasting capital expenditures of C$83.3 million, of which it will fund C$67.7 through federal and provincial grants. The remainder of the funds will come from other donations and gifts (C$1.6 million), other income (C$1 million), and transfers from other funds (C$3.2 million), resulting in an net impact of negative C$9.9 million. McMaster historically uses a revolving fund composed of unrestricted surpluses and residual amounts from the 2002 bond issue not permanently assigned to building projects to fund some capital expenditures.

Also in fiscal 2012, the university will be completing two projects in progress; the Centre for Spinal Cord Injury and Cancer Education and Research (C$20 million) and the Nuclear Reactor Building Renovation (C$22 million). Both projects were fully funded under a federal program.

Postemployment Liabilities: Decreasing But Remain High

Many Canadian universities suffered erosion in the funded status of their pension plans in the past few years. McMaster, which maintains a defined-benefit plan as well as other postemployment liabilities, was no exception. The university has made considerable gains in managing the growth of the postemployment liabilities, such as changes in plan design away from defined benefit, revised eligibility rules for some new employees, the introduction of a group RRSP for certain new employees, and increased employee contributions. Nevertheless, the funding deficit remains very large and will continue to pressure the budget greatly in the medium term.

In fiscal 2011, McMaster's pension assets continued their rebound from the recession; however, a large unfunded liability remains. The university estimated it had an unfunded pension liability of C$211 million at April 30, 2011, in its registered pension plans, an improvement over the previous year. However, McMaster's total unfunded postretirement liability (which is primarily attributable to pensions and health benefits) stands at C$481 million in fiscal 2011 and is one of the highest among its rated peers.

Recent solvency relief might reduce payments

Until recently, Ontario required institutions to amortize their plans' going-concern deficits over 15 years and solvency deficits over five years. However, in response to the increasing number of institutions with large plan deficits, it announced regulations earlier this year to partially relax the more punitive solvency amortization requirement. Under the new regulations, the province requires institutions seeking solvency relief to follow a two-stage process. In the first stage, institutions must submit a funding plan that includes estimated savings targets to improve their plans' sustainability in the long-term. If accepted, institutions will receive a three-year holiday on their solvency amortization payments (the solvency payment exemption period), although they must pay deficit interest and amortize any going-concern deficits over 15 years. At the end of three years, Ontario will require institutions to submit a report that measures progress against the original savings targets. If deemed satisfactory, the province will permit institutions to take advantage of the second stage, which lengthens institutions' required amortization period of solvency deficits to 10 years from five. McMaster has applied for, and been granted, solvency relief in respect of its Hourly Pension Plan and its Salaried Pension Plan.

McMaster University -- Peer Comparison

	McMaster University		University of Guelph		York University	
Thou. C$ (except FTE and ratios)	2011	2010	2011	2010	2011	2010
Issuer credit rating	AA-/Stable/--	AA-/Stable/--	A+/Stable/--	A+/Stable/--	AA-/Stable/--	AA-/Stable/--
Applicants	31,046	30,970	26,106	27,427	58,402	58,210
Offers	19,631	19,644	15,343	14,678	40,879	41,812
Registrants	5,109	5,016	5,332	4,302	NA	NA
Acceptance Rate (Offers/Applicants) (%)	63	63	59	54	70	72
Yield (Registrants /Applicants) (%)	16	16	20	16	NA	NA
FTEs	25,399	25,007	20,619	19,772	47,894	46,644
Total revenue	859,507	828,373	678,404	634,034	923,016	890,385
Deferred capital	34,688	36,386	22,442	21,372	11,698	12,846
Adjusted revenue	824,819	791,987	655,962	612,662	911,318	877,539
Total expenditure	837,556	816,723	652,553	636,624	926,551	894,803
Total interest expense	9,900	9,969	11,836	11,278	19,591	21,060
Depreciation	61,115	62,474	39,257	38,541	39,959	41,225
Adjusted expenditure (For DSCR)	766,541	744,280	601,460	586,805	867,001	832,518
Current portion of long-term debt (for calculating DSCR)	12,744	1,128	17,543	3,658	4,430	4,181
Consolidated surplus (%)	2.6	1.4	3.8	(0.4)	(0.4)	(0.5)
Consolidated surplus (for calculating DSCR; %)	7.1	6.0	8.3	4.2	4.9	5.1
DSCR (interest and principal; x)	2.6	4.3	1.86	1.73	1.8	1.8
DSCR (interest only; x)	5.9	4.8	4.60	2.29	2.3	2.1
Total debt	174,143	173,270	185,060	179,082	310,941	315,123
Unfunded postemployment liabilities	480,964	579,116	484,246	409,976	361,997	353,581
Interest expense to adjusted revenue (%)	1.2	1.3	1.8	1.8	2.1	2.4
Debt to FTE	6,856	6,929	8,975	9,057	6,492	6,756
Debt to adjusted revenue (%)	21.1	21.9	28.2	29.2	34.1	35.9
(Debt plus unfunded)/adjusted revenue (%)	79.4	95.0	102.0	96.1	73.8	76.2
Internally restricted net assets	6,416	(1,740)	156,483	115,117	148,502	160,199
Internally restricted endowments	114,833	107,817	20,133	18,561	40,533	36,324
Externally restricted endowments	329,272	287,854	190,242	162,230	290,799	257,496
Unrestricted financial resources	121,249	106,077	176,616	133,678	189,035	196,523
As % of total debt	69.6	61.2	95.4	74.6	60.8	62.4

McMaster University -- Peer Comparison (cont.)						
As % of total debt plus unfunded post-employment liabilities	18.5	14.1	26.4	22.7	28.1	29.4
As a % of operating expense	14.5	13.0	27.1	21.0	20.4	22.0
Per FTE	4,774	4,242	8,566	6,761	3,947	4,213
Total endowment value per FTE (at market value)	20,201	18,425	10,573	9,574	7,057	6,303

Total debt for McMaster is debt + guarantees related to First Longwood Innovation Trust but not including decommissioning obligation or swap arrangements. FTE--Full-time equivalent. DSCR--Debt service coverage ratio. N.A.--Not available.

Related Criteria And Research

General Criteria: Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

Ratings Detail (As Of June 11, 2012)	
McMaster University	
Issuer Credit Rating	AA-/Stable/--
Senior Unsecured	AA-
Issuer Credit Ratings History	
08-Dec-2010	AA-/Stable/--
09-Sep-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.