

McMaster University

May 12, 2022

This report does not constitute a rating action.

Credit Highlights

Overview

Enterprise profile

McMaster's solid market position and excellent student quality metrics underpin its very strong enterprise profile.

--Enrollment growth is expected to continue at a more sustainable level following an unusually large increase in fall 2020.

--The strong management team has ably managed operating pressures through the COVID-19 pandemic with no material deterioration in the university's credit profile.

--The core catchment area within the Province of Ontario has excellent economic fundamentals and supportive demographics.

Financial profile

Continued operating surpluses will maintain a very strong financial profile in the next several years.

--Although inflationary pressures could weigh on performance, we believe that robust student demand will support ongoing operating surpluses.

--In our view, McMaster's debt burden remains moderate following the issuance of C\$150 million of debt in fiscal 2022.

--Excellent investment returns in fiscal 2021 significantly boosted the university's liquidity.

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S&P Global Ratings' long-term issuer credit rating on McMaster University is 'AA'. The rating reflects McMaster's 'aa' stand-alone credit profile, which is based on our combined assessment of the university's very strong enterprise and financial profiles. The rating also reflects our opinion of a moderately high likelihood that the Ontario government would provide extraordinary support in the event of financial distress. The pandemic has significantly disrupted on-campus activities and ancillary operations at McMaster in the past two years; however, robust student demand has helped to buoy operating margins while especially strong investment returns in fiscal 2021 boosted liquidity, helping to maintain overall credit metrics. We believe that McMaster's excellent market position will help maintain the university's good financial performance in the next several years.

Outlook

The stable outlook reflects our expectation that in the next two years, McMaster will maintain high levels of cash and investments, at more than 3x debt, sufficient to finance its capital priorities and meet all required debt service requirements. We also believe that on a sustained basis, the university will continue to generate positive consolidated operating margins and maintain a healthy enrollment and demand profile. The ratings also reflect our expectation that McMaster's relationship with the Province of Ontario will be stable and that our assessment of the likelihood of extraordinary support will remain moderately high.

Downside scenario

We could take a negative rating action if, in the next two years, consolidated net margins declined substantially to near-balance or sustained deficit, with a subsequent material erosion in liquidity. All else being equal, a negative rating action on Ontario of up to one notch is unlikely to result in a similar rating action on McMaster. However, negative government intervention or a significant reduction in the university's resilience to an Ontario default scenario could cause us to lower the ratings.

Upside scenario

We could take a positive rating action in the next two years if our assessment of the enterprise profile improves following a selectivity ratio consistently below 50% and strong enrollment growth continues such that the university sustains a cumulative five-year full-time enrolment growth trend of more than 15% over the next several years. This would demonstrate strong growth prospects and a rapidly improving demand profile, which could in turn enhance the university's enrollment flexibility and contribute to more diversified revenue sources.

Rationale

We believe McMaster has a very strong enterprise profile. Supporting our opinion is our assessment of the higher education sector's low industry risk, characterized by countercyclicality and low competitive risk and growth. In addition, the university benefits from excellent economic fundamentals, as measured by the province's GDP per capita, estimated to be almost US\$55,800 in 2022; good income indicators; and moderate employment and population growth projections.

In addition, McMaster's robust market position and healthy student demand and enrollment trends underpin the university's enterprise profile. In fall 2021, full-time equivalents (FTEs) totaled 35,152, a 1.0% increase from the previous year. This was the lowest growth rate experienced in the past six years but was in line with the university's plan following an unusually large 8.2% increase in fall 2020 as the university extended more domestic undergraduate offers to pre-empt an expected decline in enrollment stemming from the pandemic, which ultimately did not materialize. We view the enrollment growth in 2020 as an outlier and believe that FTE growth will continue at more modest and sustainable levels in the next several years. The university's enrollment growth plan is centered largely on attracting more international students, with a target enrollment of 20%, gradually increasing from the current 16%.

In our opinion, student quality metrics remain strong, comparing well with those of similarly rated Canadian peers. These are primarily reflected in McMaster's high retention and six-year graduation rates averaging about 92% and 81%, respectively, in the past five years, as well as first-year selectivity rates of about 52%.

In our view, McMaster's management expertise and governance practices, as well as financial management policies, are very strong and in line with those of other highly rated Canadian universities. The university's academic and operational priorities are guided by its strategic plan and its Strategic Mandate Agreement with the province. These, in turn, inform the detailed three-year operating budget and capital plans. Management reviews plan performance annually, tracks progress against specific activity indicators, and monitors risks identified through its enterprise risk management framework. The university has formal policies for endowments, investments, and debt, and meets standard annual disclosure requirements. Overall, we view McMaster's transparency and disclosure to be very good, with policies and procedures in place to adequately mitigate risks, and we believe that the university's overall financial policies are not likely to negatively affect its ability to service its debt and meet other financial obligations.

We expect McMaster will maintain its very strong financial profile. In fiscal 2021, excellent investment returns boosted the university's adjusted operating margin to 14.2%, a significant improvement from the previous five-year average of 7.5%. Increased domestic and international enrollment drove higher tuition revenue while McMaster was able to keep overall expenses flat year over year, helping to offset materially lower revenue from ancillary services stemming from pandemic-related campus closures. We believe the demonstrated resiliency of McMaster's demand profile and its ability to manage revenues and expenses during a period of significant stress will allow the university to continue generating overall positive operating results over the longer term despite current inflationary pressures.

Similar to that of Canadian peers, the university's limited flexibility to increase its student-generated revenues somewhat offsets its strong financial performance. This is primarily because Ontario monitors and guides domestic tuition rates and student aid (through the tuition framework) and domestic enrollment expansion (through operating grants). However, universities can ultimately decide their enrollment targets and have control over their long-term strategies.

In June 2021, in line with our expectations, the university issued C\$150 million of fixed-rate senior unsecured bullet debentures to finance planned capital (C\$125 million of 50-year debentures and C\$25 million of 30-year green debentures). Although this lowered its ratio of available resources to pro forma debt to 1.7x at the end of fiscal 2021 from almost 2.2x in the previous year, McMaster, in our view, maintains a moderate debt burden backed by good operating performance and a healthy level of available resources. The university's long-term pro forma debt totals about C\$420 million and predominantly consists of fixed-rate bullet debentures maturing between 2051 and 2071. McMaster's pro forma maximum annual debt service burden was 3% of its fiscal 2021 adjusted operating expenses. At the end of fiscal 2021, the university held almost C\$43 million in voluntary sinking funds to repay its bullet debentures outstanding, which we have included in our measure of internally restricted net assets. McMaster also has a long-term obligation of C\$14.3 million for the gradual decommissioning of its nuclear reactor. To offset this obligation, management has accumulated trust funds of more than C\$15 million.

We believe McMaster has some exposure to contingent liabilities through its two ongoing public-private partnerships (PPPs), although they are, in our opinion, unlikely to lead to additional direct financial obligations for the university. The first, McMaster's Main Street student residence, is underway and located on land wholly owned by the university; it will be financed by a limited partnership. The project is scheduled for completion in August 2023. The second PPP is a downtown graduate student residence and parking garage for which the university has entered into a 99-year land lease with four 25-year renewal options and that is scheduled for completion by 2022-2023. Although these projects are structured such that there is no recourse to McMaster, they will provide important services to students in support of the university's mission. Therefore, we believe that if the projects were to experience significant stress, McMaster might be compelled to provide more direct oversight or support. Based on McMaster's public disclosures, we do not believe the university has any additional contingent liabilities that could materially affect our view of its credit profile.

We believe that postemployment liabilities continue to offset McMaster's financial profile strengths despite solid plan asset returns in fiscal 2021 that improved its defined-benefit salaried pension plan's funded status to a C\$117 million surplus (on an accounting basis) from a C\$171 million deficit the year before. Despite market volatility, McMaster believes its initiatives to manage its pension, including increased employee and employer contributions, will allow it to cover any special solvency pension deficit payments that may be required over the longer-term.

In our view, McMaster has very healthy liquidity with C\$1.9 billion of total cash and investments at the end of fiscal 2021. This was equal to 2.6x its available financial resources, 180% of adjusted operating expenses, and more than 4.5x our pro forma debt estimate. The university had C\$724 million of unrestricted resources available, or 68% of adjusted operating expenditures, a significant increase from recent years on much stronger investments returns in fiscal 2021. Taken together, this indicates very robust liquidity, which bolsters our assessment of the financial resources potentially available to McMaster under a stress scenario. We believe the university's available resources will remain more than sufficient to support capital investments, finance all debt service requirements, and cushion fluctuations in the market value of its portfolio in the medium term. In addition, the university has an undrawn committed credit facility totaling C\$75 million. The strong market returns also boosted the market value of McMaster's endowments to C\$895 million (of which C\$756 million was held in a long-term investment pool and the remainder in deferred donations) from C\$732 million at fiscal year-end 2020. The university has a conservative endowment draw, in our view, with a long-term payout target rate of 4% of the endowment's market value.

Moderately high likelihood of extraordinary provincial government support

In accordance with our criteria for government-related entities (GREs), our view of McMaster'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. Our view also reflects the province's oversight, program approval rights, and tuition regulation over McMaster, which suggest a strong link to it. Also supporting our assessment of the link are the province's appointment of six of 37 board of governors members and the substantial operating grants received from the province, which while declining modestly in the past five years, account for about 23% of the university's total revenue.

We rate McMaster two notches above Ontario. The maximum differential allowed is three notches, in accordance with our methodology for rating GREs that we believe depend on ongoing government support. The differential reflects our view that there is a measurable likelihood that McMaster's substantial financial resources would meet ongoing operational and debt service requirements should the government default and temporarily suspend payments to the university. In addition, the differential reflects McMaster's ownership structure, in which the government is neither an owner nor shareholder; status as an autonomous legal entity with ownership of its assets; and our view that the university operates independently of the Ontario government. The board is responsible for the management, administration, and control of the university's property and other assets and all business affairs. We consider the risk of extraordinary negative government intervention low, given McMaster's operational independence, its 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 and a freeze in the following two years. The government subsequently extended the freeze on tuition for in-province students to 2022-2023, with the ability to increase fees for domestic out-of-province students by up to 5%, up from 3%. Furthermore, the province did not provide additional grant revenue to offset the tuition cut and has yet to release an updated tuition framework beyond fiscal 2024. Neither the federal nor provincial government has announced material direct financial support for universities to offset impacts from the pandemic, although the federal government introduced an emergency income support program for students in 2021 and has increased its grant programs, which helped mitigate affordability concerns. Although we do not expect 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 McMaster 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 McMaster's environment and governance risk are in line with our view of the sector as a whole. For more information, see the criteria article "Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021," published Oct. 10, 2021.

Key Statistics

McMaster University -- Selected Indicators

--Fiscal year ended April 30--

Medians for
'AA' U.S.
public
colleges &
universities*

(Mil. C\$)	2022	2021	2020	2019	2018	2020
Enterprise profile						

McMaster University

Full-time equivalent enrollment (no.)	35,152	34,791	32,148	30,995	29,758	38,513
Selectivity rate (%)	51.7	58.5	51.9	51.2	52.6	68.9
Undergraduates as a % of total enrollment	85.9	86.5	85.4	85.3	85.7	78.7
Retention rate (%)	92.1	94.0	91.3	91.6	91.0	86.7
Graduation rates (%)	82.2	82.1	80.7	80.1	79.0	MNR
Financial profile						
Adjusted operating revenue	N.A.	1,220.3	1,173.2	1,16.3	1,100.7	MNR
Adjusted operating expense	N.A.	1,068.3	1,080.5	1,051.8	1,017.1	MNR
Net adjusted operating margin (%)†	N.A.	14.2	8.6	12.8	8.2	0.8
Student dependence (%)	N.A.	36.7	33.8	31.9	31.1	40.0
Government operating grant dependence (%)	N.A.	22.8	23.5	23.1	24.8	19.3
Investment income dependence (%)	N.A.	16.3	2.2	6.0	4.7	1.3
Outstanding debt§	N.A.	421.0	273.3	275.0	276.3	1,021.7
Maximum annual debt service§/total operating expense (%)	N.A.	3.0	2.0	2.1	2.2	3.3
Available resources to adjusted operating expenses (%)	N.A.	67.8	55.4	57.8	54.9	36.2
Available resources to total debt§ (%)	N.A.	171.9	218.9	221.0	202.1	104.9

*U.S. median figures are in U.S. dollars. †As % of adjusted operating expense. §2021 figure is pro forma including C\$150 million of debt issued after the fiscal year-end. N.A.--Not available. MNR--Median not reported.

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: 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 Detail (as of May 12, 2022)*

McMaster University

Issuer Credit Rating

AA/Stable/--

Senior Unsecured

AA

Ratings Detail (as of May 12, 2022)*

Issuer Credit Ratings History

20-May-2016	AA/Stable/--
08-Dec-2010	AA-/Stable/--
09-Sep-2002	AA/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings 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.

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