Research Update:

McMaster University Ratings Affirmed At 'AA'; Outlook Is Stable

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Overview

- We expect McMaster University's enterprise risk profile will remain very strong, supported by the university's solid reputation and excellent market position.
- Despite the university's limited revenue flexibility and inflation, we expect management will maintain robust financial performance, fueled by steady enrollment trends and a moderate debt burden.
- Therefore, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on McMaster.
- The stable outlook reflects our view that the university will maintain its excellent market position and very strong operating margins with high levels of financial resources.

Rating Action

On May 25, 2023, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on McMaster University, in the Province of Ontario. The rating action is aligned with S&P Global Ratings' criteria "Global Not-For-Profit Education Providers," published April 24, 2023.

Outlook

The stable outlook reflects our view that McMaster will maintain an excellent market position, which will support very strong operating margins, and will continue to demonstrate high levels of financial resources compared with debt.

The outlook also reflects 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 lower the rating in the next two years if management fails to maintain balanced operating margins, diminishing the levels of cash and investments, and issues additional debt to complete its capital plan. 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 rating.

Upside scenario

We could raise the rating if the university improves its selectivity ratio to below 50% while increasing its enrollment growth rates, or if we project cash and investments will stabilize at levels above 6x the debt outstanding.

Rationale

The rating reflects our view of the university's anchor, which S&P Global Ratings assesses at 'aa'. This reflects our combined assessment of McMaster's very strong enterprise risk and financial risk profiles, supported by the university's strong reputation as a research-intensive, medical-doctoral university and member of the U15, a group of leading universities in Canada. We expect the university's enrollment will be steady, leading to strong financial resources compared with debt.

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.

Enterprise profile: McMaster's very strong enterprise risk profile is supported by its academic reputation and strong market position.

Our rating on McMaster is supported by our assessment of the higher education sector as low-risk industry. The sector has low competitive risk compared with other sectors because it is anti-cyclical in nature. The university benefits from excellent economic fundamentals, as measured by the province's GDP per capita, estimated at almost US$54,200 in 2023.

McMaster's robust market position and steady enrollment trends underpin the university's enterprise profile. In fall 2022, full-time equivalents (FTEs) totaled 34,963, a decrease of 0.5% from the previous year. We believe this level will continue to decline since McMaster's domestic undergraduate enrollment is above the funded corridor, according to the provincial funding model, and management aims to bring down the over-enrollment experienced during the COVID-19 pandemic years in the next two years. Consequently, the selectivity rate indicates a slight improvement to 51.8% in fall 2022 from 52.3% in the previous year. Meanwhile, the university's enrollment growth plan focuses on attracting more international students, with a target enrollment of 24% by 2032, gradually increasing from the current 17%.

In our opinion, market quality metrics remain strong, comparing well with those of similarly rated Canadian universities. These are primarily reflected in McMaster's high retention of 92.2% on a three-year weighted-average basis and a rate of 98.6% of faculty holding advanced degrees in 2022.

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 both McMaster's strategic plan and 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 external risks, including climate and cyber risks.

Financial profile: We expect McMaster will maintain a very strong financial profile over the outlook horizon, sustained by robust operating margins and high levels of cash and investments.

We estimate that in fiscal 2023 (ended April 30) McMaster's operating margin will remain positive, supported by increased ancillary revenues and the recovery of investment income following negative returns in 2022. We also expect management's cost-saving efforts will help to balance inflationary pressures.

Similar to that of other Canadian universities, McMaster'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).

McMaster, in our view, has a moderate debt burden backed by good operating performance and extremely strong cash and investments compared with those of most similarly rated universities. Debt outstanding mainly consists of four fixed-rate bullet bonds totaling C$390 million due between 2052 and 2071 and an amortizing bank loan of C$12.5 million. We estimate McMaster's maximum annual debt service (MADS) burden at 2.7% of the university's adjusted operating expenses in fiscal 2023. At the end of fiscal 2022, the university held C$55 million in sinking funds to repay its bullet debentures outstanding. McMaster also has a long-term obligation of C$18.6 million for the gradual decommissioning of its nuclear reactor. We don't expect McMaster will increase its debt over the next one-two years.

In our view, the university has very robust liquidity, supported by exceptional cash and investment performance. We estimate that in fiscal 2023, total cash and investments were C$2.2 billion, 5.2x total debt.

The funded status of McMaster's pension plan resulted in a deficit of C$6.8 million in fiscal 2022 (on an accrual basis) compared with a C$117.4 surplus in the previous year. Despite market volatility, management believes initiatives to manage its pension, including increased employee and employer contributions, will allow it to cover any special solvency pension deficit payments that might be required in the longer term.

We believe McMaster has some exposure to contingent liabilities through its two ongoing public-private partnerships (PPPs), although, in our opinion, they are unlikely to lead to additional direct financial obligations for the university. McMaster's Main Street student residence for graduate students is scheduled to start occupancy in September 2023. The second PPP is an undergraduate student residence that is expected to open in fall 2026. Both projects are in the development process. Although these projects are structured such that there is no recourse to McMaster, and 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.

GRE analysis: Moderately high likelihood of extraordinary provincial government support

We believe that the university has an important role in the province, specifically because postsecondary education is one of Ontario's priorities in both expenditure and mandate after health care and school boards; therefore, in accordance with our criteria for government-related entities (GREs), our view is that McMaster has a moderately high likelihood of extraordinary government support. Our view also reflects the province's oversight, program approval rights, and tuition regulation over McMaster, which suggests a strong link to it. Also supporting our assessment of the link is the large operating grants received from the province, accounting for about 21% of McMaster's total revenue.

We rate McMaster two notches above Ontario. The maximum differential is three notches, 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 McMaster'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 McMaster's ownership structure, in which the government is neither an owner nor shareholder. We consider the risk of extraordinary negative government intervention low, given the university's operational independence and important public policy role.

In January 2019, the government of Ontario imposed a 10% reduction to domestic tuition for the 2019-2020 academic year and a freeze through 2023-2024. Furthermore, the province did not provide additional grant revenue to offset the tuition cut and is targeting the implementation of performance-based funding in fiscal 2024. 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 there is a moderately high likelihood that the province would provide support to McMaster in a distress scenario.

Environmental, Social, And Governance

We view the health and safety social risks posed by the pandemic as abating for the higher education sector; however, given the pandemic's significant effects on modes of instruction and enrollment trends over the past three years, we believe a future public health event of similar size and scope could again affect demand and finances. We evaluated McMaster's environmental and governance factors and found them to be neutral in our credit analysis as a whole.

Key Statistics

Table 1

McMaster University--selected indicators

	--Fiscal year ended April 30--					--Medians*--
(Mil. C$)	2023e	2022	2021	2020	2019	2021
Enterprise risk profile						
Full-time equivalent enrollment (no.)	34,963	35,152	34,791	32,148	30,995	37,225
Annual FTE percent change (%)	(0.5)	1.0	8.2	3.7	4.2	0.1
Selectivity rate (%)	51.8	52.3	58.5	51.9	51.2	70.6
Undergraduates as a % of total enrollment	85.7	85.9	86.5	85.4	85.3	80.6
Retention rate (%)	91.5	92.1	94	91.3	91.6	86.4
Graduation rates (six years) (%)	82.1	82.2	82.1	80.7	80.1	70.0
Financial risk profile						
Adjusted operating revenue	1,326.1	1,367.6	1,220.3	1,173.2	1,186.3	MNR
Adjusted operating expense	1,205.8	1,153.9	1,068.3	1,080.5	1,051.8	MNR
Net adjusted operating margin (%)†	10.0	18.5	14.2	8.6	12.8	3.5
Student dependence (%)	N.A.	34.7	36.7	33.8	31.9	36.3
Government operating grant dependence (%)	N.A.	20.8	22.8	23.5	23.1	16.5
Cash and investments	2,214.2	2,033.1	1,918.5	1,514.6	1,555.4	MNR
Cash and investments to operation expenses (%)	183.6	176.2	179.6	140.2	147.9	MNR
Outstanding debt	420.4	421.2	271.7	273.3	275.0	862.0
Cash and investments to debt (%)	526.7	482.7	706.1	554.2	565.6	185.2
Current MADS burden (%) †	2.7	2.8	2.1	2.0	2.1	3.4

e--Estimated. *For 'AA' rated U.S. public colleges and universities. U.S. median figures are in U.S. dollars. †As % of adjusted operating expense. N.A.--Not available. MNR--Median not reported.

Ratings Score Snapshot

Table 2

McMaster University--ratings score snapshot

Key rating factors	Scores
Industry risk	2
Economic fundamentals	1
Market position	2
Management & governance	2
Enterprise risk profile	2
Financial performance	2
Financial resources	1
Debt and contingent liabilities score	2
Financial risk profile	2

Table 2

McMaster University--ratings score snapshot (cont.)

Key rating factors	Scores
Stand-alone credit profile	aa
Issuer credit rating	AA

S&P Global Ratings bases its ratings on global not for profit education providers on the seven main rating factors listed in the table above. S&P Global Ratings' "Global Not-For-Profit Education Providers," published on April 24, 2023, summarizes how the seven factors are combined to derive each global not for profit education provider's stand-alone credit profile and issuer credit rating.

Related Criteria

- Criteria | Governments | General: Global Not-For-Profit Education Providers, April 24, 2023
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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: Credit Quality Continues To Diverge, Jan. 18, 2023
- Australia, Canada, Mexico, And U.K. Universities Medians: Fiscal 2021 Credit Trends Turned Positive Despite Challenges, Oct. 20, 2022
- U.S. Not-For-Profit Public College And University Fiscal 2021 Median Ratios: Federal and State Funds Relieve Pandemic Pressure, Elevate Margins, July 12, 2022

Ratings List

Ratings Affirmed	
McMaster University	
Issuer Credit Rating	AA/Stable/--
McMaster University	
Senior Unsecured	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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.