S&P Global Ratings

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Research Update:

McMaster University 'AA' Ratings Affirmed; Outlook Is Stable

May 17, 2021

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Overview

- The COVID-19 pandemic has contributed to slightly weakened operating margins for McMaster University.
- However, the university's credit profile has remained resilient despite border and campus closures, with strong domestic undergraduate demand and robust levels of liquidity underpinning the rating.
- We are affirming our 'AA' long-term issuer credit and senior unsecured debt ratings on McMaster.
- The stable outlook reflects our expectation that despite pressures on revenues, liquidity, and potentially international enrollment stemming from the pandemic, the university will maintain a very strong market position and student demand profile, a manageable debt burden, and high levels of unrestricted financial resources in the next two years.

Rating Action

On May 17, 2021, S&P Global Ratings affirmed its 'AA' long-term issuer credit and senior unsecured debt ratings on McMaster University, in Hamilton, Ont. The outlook is stable.

Outlook

The stable outlook reflects our expectations that McMaster's levels of cash and investments will remain high over the next two years, at more than 3x its debt, helping the university to weather the near-term revenue shocks caused by the pandemic. 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, and liquidity eroded significantly, likely as a result of prolonged social distancing measures caused by the ongoing COVID-19 pandemic. 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

Although we consider it unlikely during the two-year outlook horizon, we could take a positive rating action 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

The ratings reflect the university's stand-alone credit profile, which S&P Global Ratings assesses at 'aa'. This reflects our combined assessment of the university's very strong enterprise and financial profiles. 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.

We believe the pandemic represents a short-term risk to McMaster and other universities we rate. It had a modest impact on the university's overall financial results in fiscal 2020 (ended April 30), with most of the decrease in the year's operating margin being attributed to poor investment returns, which have since largely recovered. The university's fall 2020 total enrollment remained strong due to a higher number of acceptances, despite ongoing restrictions to travel, on-campus activities, and other challenges to international enrollment. Although the ongoing pandemic will continue to dampen the university's financial performance in the near term, primarily due to pronounced weakness in the ancillary operations, we believe McMaster's financial performance will recover as the pandemic-related restrictions ease. However, we believe that the threat of more protracted pandemic-related travel restrictions, and limits to on-campus activities and student mobility, could still pose a material risk to longer-term student demand and enrollment growth, particularly international students, which could affect the university's enterprise and financial profiles.

Founded in 1887, McMaster University is a research-intensive, medical-doctoral university dedicated to teaching, research, and service. Its main campus (94% of the student population) is in Hamilton, the fifth-largest city in Ontario; the university has smaller satellite campuses in downtown Hamilton, Burlington, Waterloo, and St. Catharines. McMaster offers a variety of undergraduate and graduate degrees across its six faculties (business, engineering, health sciences, humanities, science, and social sciences). The university is a member of the U15, a group of leading research-intensive universities in Canada. It is ranked 69th in the 2021 Times Higher Education list of the top universities globally (up from 72nd in 2020), fourth in Canada, and placed 14th worldwide in the 2021 Times Higher Education Impact Ranking (up from 15th).

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 about US$47,800 in 2021; 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 2020, full-time equivalents (FTEs) totaled 34,791, an 8.2% increase from the previous year (compared with average growth of 3.6% in the previous four years). This large increase is tied to McMaster's higher first-year selectivity rate of 58.5% (offers as a proportion of applicants; up from 52% the year before) due to the university extending more domestic undergraduate offers to pre-empt the potential impacts of the pandemic on enrollment, which did not materialize as feared. This rise is on par with that of most Canadian peers and we view fall 2020 enrolment growth as an outlier. It is our view that the FTE growth and selectivity ratio will return to normal levels as the pandemic eases and border closures are lifted. 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 average entry grade rates of 92% and 90%, respectively. The six-year graduation rate improved to 82.1% from 80.7% in fall 2019 and 78% in 2016.

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 (most recently issued in April 2021 by the new president) 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 to maintain a very strong financial profile over the outlook horizon. Its adjusted operating margin was 8.6% in fiscal 2020, a slight decline from 12.8% in the previous fiscal year. Despite the moderate decline, McMaster largely avoided the impacts of the pandemic in fiscal 2020, as most grants and tuition had been received before the end of April, and the fall in revenues was primarily caused by investment income losses in the final quarter of the year. The fiscal 2021 operating budget initially projected a deficit of C$23 million in the operating fund due to the pandemic; however, the revised budget now projects a surplus of C$42.1 million, as enrollment growth was very strong and the university reduced expenditures in line with limited ancillary activity and enacted other cost-saving measures. We believe this demonstrates the resiliency of McMaster's demand profile and the university's ability to manage revenues and expenses during a period of significant pressure. Although we believe that ongoing pandemic-related pressures will depress operating results in the current fiscal year, we expect that the university will continue to generate overall positive operating results over the longer term.

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.

McMaster, in our view, has a moderate debt burden backed by good operating performance and a healthy level of available resources. Based on its strategic and capital plans, we expect that the university could issue debt in fiscal 2022, lowering its available resources-to-debt ratio to between 1x-2x, from almost 2.2x at the end of fiscal 2020. We do not believe that this would result in a material weakening of the university's financial profile. Debt outstanding mainly consists of two fixed-rate bullet bonds totaling C$240 million due in 2052 and 2065, and includes C$14 million in amortizing bank loans and guaranteed debt of C$19 million. McMaster's maximum annual debt service burden was 2% of its adjusted operating expenses in fiscal 2020. At the end of fiscal 2020, the university held C$34 million in 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$13.6 million for the gradual decommissioning of its nuclear reactor. To offset this obligation, management has accumulated trust funds of approximately C$11.7 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 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 the steps taken by both the province and the university to address the solvency deficit. The university's defined-benefit salaried pension plan's funded status on an accounting basis was a deficit of about C$171.2 million. McMaster believes its initiatives to manage its pension deficit, including increased employee and employer contributions, will allow it to cover any special solvency pension deficit payments that may be required.

Liquidity

We view the university's liquidity as very robust. At fiscal year-end 2020, McMaster had C$1.5 billion in total cash and investments, equal to 2.5x its available financial resources, 140% of adjusted operating expenses, and more than 5.5x current outstanding debt (as well as greater than 3x our pro forma debt estimate). Taken together, this indicates very robust liquidity, which bolsters our assessment of the financial resources potentially available to McMaster under a stress scenario. Unrestricted available financial resources totaled C$598 million, or 55% of adjusted operating expenditures, slightly lower than in previous years. We believe that available resources could decline somewhat in the next two years due to ongoing pressures from the pandemic. However, we believe that available resources will remain more than sufficient to weather near-term stresses and finance all debt service requirements. In addition, the university has an undrawn committed credit facility totaling C$75 million. At the end of fiscal 2020, the total market value of McMaster's endowments decreased to C$732 million (of which C$617 million was held in a long-term investment pool and C$115 million in deferred donations) from C$758 million at fiscal year-end 2019, as a result of weaker market conditions in the last fiscal quarter. 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 large operating grants received from the province, accounting for an average of about 24% of the university's total revenue in the past four years, and the province's appointment of six of 37 board of governors members.

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 of Ontario imposed a 10% reduction to domestic tuition for the 2019-2020 academic year and a freeze in 2020-2021. 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 2021. 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 income support program for students, which helped 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 McMaster in a distress scenario.

Environmental, social, and governance factors

In S&P Global Ratings' view, higher education entities face elevated social risk due to the ongoing uncertainty regarding the duration of the COVID-19 pandemic, and the unknown impact on enrolment levels and mode of instruction in 2021 and beyond. 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 environmental and governance risks are in line with our view of the sector as a whole.

S&P Global Ratings believes there remains high, albeit moderating, uncertainty about the evolution of the coronavirus pandemic and its economic effects. Vaccine production is ramping up and rollouts are gathering pace around the world. Widespread immunization, which will help pave the way for a return to more normal levels of social and economic activity, looks to be achievable by most developed economies by the end of the third quarter. However, some emerging markets may only be able to achieve widespread immunization by year-end or later. We use these assumptions about vaccine timing in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly.

McMaster University -- Selected Indicators

	--Fiscal year-end April 30--					Medians for 'AA' U.S. public colleges & universities*
(Mil. C$)	2021	2020	2019	2018	2017	2019
Enterprise profile						
Full-time equivalent enrollment (no.)	36,452	34,267	33,147	31,843	31,265	36,667
Selectivity rate (%)	58.5	51.9	51.2	52.6	56.4	69.6
Undergraduates as a % of total enrollment	86.5	85.4	85.3	85.7	85.7	78.8
Retention rate (%)	94.0	91.3	91.3	91.0	90.9	85.7
Graduation rates (%)	82.1	80.7	80.1	79.0	77.5	MNR
Financial profile						
Adjusted operating revenue	N.A.	1,173.2	1,186.3	1,100.7	1,013.5	MNR
Adjusted operating expense	N.A.	1,080.5	1,051.8	1,017.1	973.4	MNR
Net adjusted operating margin (%)†	N.A.	8.6	12.8	8.2	4.1	1.5
Student dependence (%)	N.A.	33.8	31.9	31.1	30.2	41.2
Government operating grant dependence (%)	N.A.	23.5	23.1	24.8	26.7	18.3
Investment income dependence (%)	N.A.	2.2	6.0	4.7	9.7	1.4
Outstanding debt	N.A.	273.3	275.0	276.3	277.8	808.1
Maximum annual debt service/total operating expense (%)	N.A.	2.0	2.1	2.2	2.3	3.6
Available resources to adjusted operating expenses (%)	N.A.	55.4	57.8	54.9	54.3	36.7
Available resources to total debt (%)	N.A.	218.9	221.0	202.1	190.4	92.9

*U.S. median figures are in U.S. dollars. †As % of adjusted operating expense. 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: Empty Chairs At Empty Tables, Jan. 20, 2021
- U.S. Public College And University Fiscal 2019 Median Ratios Remain Generally Stable Although Operating Stress Looms, Nov. 24, 2020
- Australia, Canada, Mexico, And U.K. University Medians Report: Pandemic-Related Pressures Could Upset Recent Credit Metric Stability, Oct. 20, 2020

Ratings List

Ratings Affirmed	
McMaster University	
Issuer Credit Rating	AA/Stable/--
McMaster University	
Senior Unsecured	AA