Research Update:

University of British Columbia Ratings Affirmed At 'AA+'; Outlook Remains Stable

March 11, 2021

PRIMARY CREDIT ANALYST

Nineta Zetea
Toronto
+ 1 (416) 507 2508
nineta.zetea
@spglobal.com

SECONDARY CONTACT

Adam J Gillespie
Toronto
+ 1 (416) 507 2565
adam.gillespie
@spglobal.com

RESEARCH CONTRIBUTOR

Deepanshu Goyal
CRISIL Global Analytical Center, an
S&P Global Ratings affiliate, Mumbai

Overview

- We expect that the University of British Columbia's (UBC's) financial performance will be somewhat pressured in the near term by the COVID-19 pandemic, particularly if travel restrictions and reduced on campus fee-for-service activities persist into the next fiscal year.
- Despite these near-term challenges, we believe that UBC's flagship status will continue to support the university's enrollment demand and student quality; in addition, strong liquidity and debt metrics will support its financial profile.
- We are affirming our 'AA+' long-term issuer credit and senior unsecured debt ratings on UBC and maintaining our stable outlook.

Rating Action

On March 11, 2021, S&P Global Ratings affirmed its 'AA+' long-term issuer credit and senior unsecured debt ratings on the University of British Columbia, in Vancouver. The outlook is stable.

Outlook

The stable outlook reflects our expectations that, within our two-year outlook horizon, the university will maintain an excellent market position and demand profile; it will continue to generate positive net adjusted margins despite budgetary pressures intensified by the pandemic; and available resources will remain high. We expect that, on average, available resources will continue exceeding 25% of adjusted operating expenses and cash and investments will be over 3x total debt; and that provincial support to the university will not materially decline. The outlook also reflects our expectation that UBC's relationship with and the likelihood of extraordinary support from the province will be unchanged.

Downside scenario

We could take a negative rating action in the next two years if pandemic-related measures lead to significant disruptions to the university's operations, falling enrollment, and lower revenues, resulting in sustained operating deficits, eroded available resources that represent less than 25% of adjusted operating expenses, and cash and investments of less than 3x total debt outstanding.

Given our assessment of the very strong link between UBC and the Province of British Columbia (AAA/Negative/A-1+) that does not allow a government-related entity (GRE) to be rated above the related government, a downgrade of more than one notch on the province will result in a rating action on the university.

Upside scenario

We view an upgrade as unlikely in the next two years given the tight operating environment for universities in the province, with limited tuition flexibility, rising compensation expenses, and our expectation of flattening provincial grants. Nevertheless, all else being equal, a positive rating action on UBC could occur only if the 'AAA' ratings on the province have a stable outlook. In that scenario, we could consider a one-notch upgrade on UBC if its available resources were to increase such that they exceeded 2x debt on a consistent basis, and adjusted net operating margins returned to well above 5% of adjusted operating expenses. In addition, a more diversified revenue base and stronger financial flexibility would make UBC largely comparable with 'AAA' rated peers, justifying an upgrade.

Rationale

The ratings on UBC reflect the university's stand-alone credit profile (SACP), which S&P Global Ratings assesses at 'aa+' based on UBC'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 'AAA' rated peers offset this strength. The ratings also reflect our opinion of a high likelihood that the B.C. government would provide extraordinary support in the event of financial distress. Although it is a GRE, UBC receives no ratings uplift from the province under our criteria.

We believe the pandemic represents a near-term risk to UBC and other universities we rate. There was virtually no impact on the university's consolidated financial results in fiscal 2020 (year ended March 31). In fiscal 2021, despite ongoing restrictions to on-campus learning and other activities, UBC's enrollment exceeded its conservative expectations, resulting in higher-than-budgeted tuition revenues. The university estimates this will partly offset the weakness in revenues from ancillary operations and growth in operating expenditures, resulting in a significantly lower consolidated deficit compared with budget. However, we believe that the threat of more prolonged pandemic-related travel restrictions, and limited on-campus activities and student mobility, poses a material risk to longer-term student demand and enrollment growth, particularly international students, which could affect the university's enterprise and financial profiles.

Established in 1908, UBC is a research-intensive, doctoral university with the third-largest enrollment in Canada. It is based in Vancouver, which had an estimated population of about 700,000 in 2020. The university also has a smaller campus in Kelowna, with about 16% of total enrollment. UBC enjoys a strong international reputation, ranking 34th in the 2021 Times Higher Education list of the top universities globally. It has a comprehensive program offering across its 18 faculties, 12 schools, and two colleges on its two campuses, including faculties of law, applied science, and business, and the only faculties of pharmaceutical sciences, medicine, dentistry, forestry, and land and food systems in the province.

UBC's enterprise profile benefits from excellent economic fundamentals, given B.C.'s very strong economy, measured by GDP per capita, which we estimate at about US$42,200 in 2021; good income indicators; and moderate employment and population growth projections. In addition, a robust market position and healthy demand strengthen the university's enterprise profile. UBC estimates its annual enrollment for fall 2020 at 62,574 full-time equivalent (FTE) students, or 3.7% above enrollment in the previous fall; about 26% of FTEs were graduate and professional students, a ratio that is in line with that of most Canadian research-intensive universities. Student quality remains strong, as reflected in the university's historically gradually improving retention and graduation rates of about 94% and 79%, respectively, in the past year. UBC's selectivity ratio is about 36%, in line with that of other flagship universities. As well, the university has good geographic diversity, with about 41% of its students coming from outside B.C. and about half of those international students. We believe that the coronavirus outbreak will not have a material impact on UBC's enrollment in the near term. However, if the effects are broader and more prolonged than currently estimated, it could reduce international student application levels. In our opinion, UBC benefits from robust fundraising capabilities, which are reflected in its most recent official campaign when it exceeded its target, and in annual fundraising of about C$200 million.

In our view, UBC's management expertise and governance practices, as well as financial management policies, are very strong and in line with those of other Canadian universities. UBC prepares audited financial statements and unaudited quarterly updates, as well as limited financial forecasts for four years. Its annual budget is presented consolidated, with the operating fund accounting for close to 75% of total consolidated revenues. The operating and capital plans contain what we view as reasonable assumptions. Overall, we view UBC's transparency and disclosure as good and comparable with those of peers, with policies and procedures in place to adequately identify and mitigate risks, which we expect will continue to be implemented effectively. The university has formal policies for endowments, investments, and debt (which includes several benchmark targets). Its academic and operational priorities are guided by its strategic plan, which covers 2018-2028. The plan, which aims at establishing UBC as a leader in research and teaching, focuses on four core areas (people and places, research excellence, transformative learning, local and global engagement) and is organized around 20 strategies. The university reviews plan performance annually, tracks progress against specific activity indicators, and monitors identified risks.

UBC has several equity investments in for-profit entities and joint ventures. For-profit entities include UBC Properties Investments Ltd., which carries out real estate development related to a provision in UBC's University Act that allows the university to lease the extensive undeveloped lands adjoining its Vancouver campus to developers via pre-paid 99-year leases, the revenue of which is deferred and recognized over the lease period. Other for-profit entities include UBC Investment Management Trust Inc., which manages the endowment assets and staff pension plan. The various joint ventures mostly involve other universities and do not significantly affect UBC's results.

In our opinion, UBC has a very strong financial profile. 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. Although UBC typically produces balanced budgets, its 2021 budget presented a deficit of C$225 million, reflecting the expected impact of the COVID-19 pandemic. However, in its second-quarter forecast, it estimated that the 2021 consolidated deficit will be much smaller (C$100 million) than budgeted, as a result of stronger-than-expected enrollment in fall 2020, which, coupled with mitigating strategies and use of reserves, partly offset the significant decrease in ancillary revenues. Although the pandemic will continue to dampen the university's financial performance in the near term, we believe UBC can gradually absorb it and return to balanced budgets. On average from 2018-2020, UBC generated an adjusted net operating margin (on a fully consolidated basis) of 4.6% of adjusted operating expenditures, which is slightly below the 5.9% average recorded last year.

UBC depends on student-generated revenues for about 30% of its total revenue and has somewhat limited flexibility to increase them. B.C. monitors and guides tuition rates and student aid (through a tuition framework) and enrollment expansion (through operating grants). However, universities have the final decision on these matters (within the tuition increase limit) and on their long-term strategies. UBC expects that in the next several years, its revenue mix will continue to shift more toward student-derived revenues, with tuition and student fee growth outpacing expectations for modest increases in provincial funding. The university continues to look at ways of diversifying its revenues sources, such as increasing campus usage during the summer months, and expanding flexible learning and graduate programs.

UBC requires provincial approval to issue debt, which it can use only for capital purposes. The university has stated its preference to access external debt, and should the B.C. government allow it to take on any additional debt in the medium term, it estimates it would be moderate. Therefore, we do not expect any material increase in the total debt burden in the near term. UBC's total gross debt outstanding was about C$381 million at fiscal year-end 2020. Net of about C$35 million of sinking funds, which the province holds and which are to repay provincial debentures, this was C$345 million, most of which is non-amortizing. It consisted of C$252 million of fixed-rate, senior unsecured bullet debentures due 2031 and 2035, a C$127 million (C$92 million net of sinking funds) fixed-rate senior unsecured bullet provincial fiscal agency loan due 2037, and about C$2 million in mortgages. The debt service burden during the year was light at only 0.8% of adjusted operating expenses. We estimate maximum annual debt service at C$34 million, which is only moderately higher at 1.2% of fiscal 2020 adjusted operating expenses.

UBC has what we view as very modest unfunded postemployment liabilities related to sick leave benefits and an income-replacement plan for disabled employees. Employees fund the costs of the latter plan. The university is not required to contribute nor is it responsible for any deficit. The accrued benefit obligation for both items at fiscal year-end 2020 was only C$10 million, or 0.2% of total liabilities. UBC sponsors a defined-contribution (DC) plan for faculty and a defined-benefit (DB) hybrid plan for staff. The staff hybrid pension plan more closely characterizes a DC plan than a DB one, in our view. Also, unlike its peers, the university is not liable for any deficit in nonpension retirement medical and dental benefits; faculty and staff pay for these. Furthermore, many of UBC's peers, particularly those offering DB pension plans, have significant funding obligations, which can have very adverse effects on a university's cash flows, operating budget, operating margin, and debt service coverage ratio. We believe the university's lack of postemployment pension and benefit liabilities places it in an enviable position relative to its peers and bolsters its credit profile. Based on public disclosures, we do not believe that UBC has any additional contingent liabilities that could materially affect our view of its credit profile.

Liquidity

The university's liquidity is excellent, in our view. At fiscal year-end 2020, UBC had C$2.6 billion in total cash and investments, equal to 3.3x available resources, 92% of adjusted operating expenses, and about 7.5x debt outstanding. Available resources (expendable endowment investments) totaled C$788.9 million, or 28% of adjusted total expenditures and 228% of debt. These levels were below those of the previous two years, and primarily reflect lower board-approved transfers from cash in 2020 compared with C$75 million and C$80 million in fiscal years 2018 and 2019, respectively; and an investment loss in 2020 compared with gains recorded in previous years. Although UBC may need to draw on its reserves as it deals with pandemic pressures, we expect these ratios will remain more than sufficient to finance all debt service requirements and provide a sufficient buffer to withstand any likely medium-term stress scenario.

At March 31, 2020, endowment assets improved to a market value of C$1.8 billion, with the principal component being 56% of the total. UBC has a conservative endowment draw, in our view, with a long-term payout target rate of 4% of the endowment's market value, which is in line with the endowment spending of other Canadian universities.

High likelihood of extraordinary provincial government support

In accordance with our criteria for GREs, we base our view of UBC's high likelihood of extraordinary government support on our assessment of its important role in the province, given that postsecondary education is one of B.C.'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 the university's strong international reputation, which its very high student quality and research profile demonstrate. We base our view of the very strong link between UBC and the province on the province's oversight, program and external debt issuance approval rights, and tuition regulation over UBC. Also supporting this view is that the province consolidates the university's debt on its own balance sheet and provides substantial operating grants, which account for about 27% of UBC's 2020 total revenue. The province also appoints 11 of 21 board members, although the Alumni Association recommends two of these.

Despite the ongoing provincial support, we believe UBC operates independently of the B.C. government. It is an autonomous legal entity with ownership of its assets. The board is responsible for the management, administration and control of property, revenue, business, and affairs of the university. Although B.C. monitors and guides tuition and student aid (through the tuition framework) and enrollment expansion (through operating grants and program approval), the university has the final decision on these matters (within the tuition increase limit) and on its long-term strategy.

Environmental, Social, And Governance Factors

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 in 2020 and beyond. We view the risks posed by COVID-19 to public health and safety as a social risk under our ESG factors. Despite the elevated social risk, we believe UBC's environment and governance risk 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.

University of British Columbia -- Enterprise and Financial Statistics

		--Fiscal year ended March 31--				
	2021 demand	2020	2019	2018	2017	Medians for 'AA' U.S. public colleges & universities, 2019†
Enrollment and demand						
Headcount	70,024	67,958	66,266	64,936	62,919	MNR
Full-time equivalent	62,574	60,358	59,036	57,146	55,394	36,667
First year acceptance rate (%)	35.8	34.0	32.8	34.9	35.4	69.6
First year matriculation rate (%)	85.1	85.8	88.3	88.4	89.8	MNR
Undergraduates as a % of total enrollment (%)	70.7	69.2	69.1	68.6	68.4	78.8
First year retention (%)	94.1	92.5	91.1	90.8	91.1	85.7
Graduation rates (six years) (%)*	78.8	76.8	74.3	72.4	74.1	MNR
Income statement						
Adjusted operating revenue (C$000s)	N.A.	2,946,989	2,750,474	2,538,515	2,417,692	MNR
Adjusted operating expense (C$000s)	N.A.	2,826,296	2,596,644	2,469,444	2,296,677	MNR
Net adjusted operating income (C$000s)	N.A.	120,693	153,830	69,071	121,015	MNR
Net adjusted operating margin (%)	N.A.	4.3	5.9	2.8	5.3	1.50
Provincial grants to revenue (%)§	N.A.	26.3	28.2	29.5	30.0	18.3
Student dependence (%)	N.A.	30.2	29.6	26.6	26.1	41.2
Investment income dependence (%)	N.A.	3.2	3.5	3.2	2.9	1.4
Debt						
Debt outstanding (C$000s)	N.A.	345,496	350,286	355,234	360,401	808,057
Current debt service burden (%)	N.A.	0.82	0.91	1.11	1.03	MNR
Current MADS burden (%)	N.A.	1.20	1.31	1.54	1.49	3.60
Financial resource ratios						
Endowment market value (C$000s)	N.A.	1,799,309	1,848,005	1,721,828	1,538,272	1,006,154
Cash and investments (C$000s)	N.A.	2,605,087	2,636,586	2,478,191	2,136,953	MNR
Adjusted UFR (C$000s)	N.A.	788,914	877,469	779,374	622,219	MNR
Cash and investments to operations (%)	N.A.	92.2	101.5	100.4	93.0	56.4

University of British Columbia -- Enterprise and Financial Statistics (cont.)

		--Fiscal year ended March 31--				
	2021 demand	2020	2019	2018	2017	Medians for 'AA' U.S. public colleges & universities, 2019†
Cash and investments to debt (%)	N.A.	754.0	752.7	697.6	592.9	169.9
Adjusted UFR to operations (%)	N.A.	27.9	33.8	31.6	27.1	36.7
Adjusted UFR to debt (%)	N.A.	228.3	250.5	219.4	172.6	92.9
Average age of plant (years)	N.A.	8.2	8.4	8.5	8.6	13.2
OPEB liability to total liabilities (%)	N.A.	0.2	0.2	0.2	0.3	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: 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
- 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	
University of British Columbia	
Issuer Credit Rating	AA+/Stable/--
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.