Methodology

Rating Public Universities

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DBRS is a full-service credit rating agency established in 1976. Privately owned and operated without affiliation to any financial institution, DBRS is respected for its independent, third-party evaluations of corporate and government issues, spanning North America, Europe and Asia. DBRS’s extensive coverage of securitizations and structured finance transactions solidifies our standing as a leading provider of comprehensive, in-depth credit analysis.

All DBRS ratings and research are available in hard-copy format and electronically on Bloomberg and at DBRS.com, our lead delivery tool for organized, Web-based, up-to-the-minute information. We remain committed to continuously refining our expertise in the analysis of credit quality and are dedicated to maintaining objective and credible opinions within the global financial marketplace.
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Introduction to DBRS Methodologies

- DBRS publishes rating methodologies to give issuers and investors insight into the rationale behind DBRS’s rating opinions.
- In general terms, DBRS ratings are opinions that reflect the creditworthiness of an issuer, a security or an obligation. DBRS ratings assess an issuer’s ability to make timely payments on outstanding obligations (whether principal, interest, preferred share dividends or distributions) with respect to the terms of an obligation. In some cases (e.g., non-investment grade corporate issuers), DBRS ratings may also address recovery prospects for a specific instrument given the assumption of an issuer default.
- DBRS rating methodologies include consideration of historical and expected business and financial risk factors as well as industry-specific issues, regional nuances and other subjective factors and intangible considerations. Our approach incorporates a combination of both quantitative and qualitative factors.
- The considerations outlined in DBRS methodologies are not exhaustive and the relative importance of any specific consideration can vary by issuer. In certain cases, a major strength can compensate for a weakness and, conversely, a single weakness can override major strengths of the issuer in other areas. DBRS may use, and appropriately weight, several methodologies when rating issuers that are involved in multiple business lines.
- DBRS operates with a stable rating philosophy; in other words, DBRS strives to factor the impact of a cyclical economic environment into its ratings wherever possible, which minimizes rating changes due to economic cycles. Rating revisions do occur, however, when more structural changes, either positive or negative, have occurred, or appear likely to occur in the near future.
- DBRS also publishes criteria which are an important part of the rating process. Criteria typically cover areas that apply to more than one industry. Both methodologies and criteria are publicly available on the DBRS website and many criteria are listed below under “Rating the Specific Instrument and Other Criteria.”
Overview of the DBRS Rating Process

- There are generally three components to the DBRS corporate rating process: (1) an industry risk rating (IRR); (2) an issuer rating; and (3) considerations for specific securities. The figure below outlines this process.
- An IRR is a relative ranking of most industries that have a DBRS methodology, typically using just three ranges of the DBRS long-term debt rating scale (i.e., “A”, BBB and BB), without making use of the “high” or “low” descriptors. The IRR is a general indication of credit risk in an industry and considers, among other things, an industry’s: (1) profitability and cash flow; (2) competitive landscape; (3) stability; (4) regulation; and (5) other factors. An “industry,” for the purposes of the IRR, is defined as those firms that are generally the larger, more established firms within the countries where the majority of DBRS’s rated issuers are based; this remains true for DBRS methodologies that are more global in nature. The industry risk rating helps DBRS set the BRR grid (see below) in that it positions, in an approximate way, an average firm in the industry onto the business risk rating (BRR) grid. For firms in industries with low IRRs, the IRR can, in effect, act as a constraint or “cap” on the issuer’s rating.
- The issuer rating is DBRS’s assessment of the probability of default of a specific issuer. It is a function of: (1) the BRR, determined by assessing each of the primary and (where relevant) additional BRR factors in the BRR grid for a specific issuer; and (2) the financial risk rating (FRR), determined by assessing each of the primary and (where relevant) additional FRR metrics. The two components, BRR and FRR, are combined to determine the issuer rating; in most cases the BRR will have greater weight than the FRR in determining the issuer rating. Throughout the BRR and FRR determination process, DBRS performs a consistency check of the issuer on these factors against the issuer’s peers in the same industry.
- The issuer rating is then used as a basis for specific instrument ratings. DBRS assigns, for example, a recovery rating and notches up or down from the issuer rating to determine a specific instrument rating for instruments of non-investment grade corporate issuers. (See “Rating the Specific Instrument and Other Criteria”)

* Depending on the instrument, “other criteria” may include the recovery methodology for non-investment grade issuers or the preferred share and hybrid criteria, for example. Please refer to the section below entitled “Rating the Specific Instrument and Other Criteria” for a list of these criteria, as well as other criteria that may be applicable at any stage of the rating process.
Public Universities Industry

• This methodology applies to public universities with an established academic track record that operate in advanced economies, with governments solidly in investment-grade territory providing a considerable portion of the university’s funding.
• Per the three-tier IRR system described on the previous page, the public university IRR is A.
• The public university sector is characterized by: (1) management to a balanced budget, rather than to profit maximization given their not-for-profit status; (2) limited local competition given the governmental control of the creation of new universities and the lack of favourable undeveloped sites close to catchment areas; (3) stable growth, generally tied to population growth and demographic factors; (4) a high degree of regulation or government control in exchange for considerable financial support from the public sector; and (5) historically a low degree of technological change, although the Internet has the potential to materially change the delivery of education services over the medium term.

OPERATING PERFORMANCE & CASH FLOW
• Public universities provide an important service and benefit from stable revenues and expenditures and predictable, although often tight, cash flows in comparison with corporate issuers.
• Strong demand fundamentals, a generally balanced supply of institutions relative to the student base, conservative management and considerable monitoring and funding from governments lend support and stability to the public university sector. Nonetheless, limited fee-setting autonomy, slow growth in government funding, aging infrastructure and cost inflation often result in tight operating flexibility.

COMPETITIVE LANDSCAPE
• The creation of new institutions is usually controlled by governments. Owing to the significant funding commitment that a new institution represents, governments rarely approve the founding of new universities, and the geographical distribution of existing institutions is generally adequate relative to the local catchment areas. As a result, well-established universities generally benefit from limited local competition and relatively sizable local catchment areas, providing a steady supply of students.
• Furthermore, since students select a university primarily based on the academic profile and location of the institution, and since government policies often constrain the tuition fees charged to domestic students to artificially low levels, public universities generally set fees at the maximum permitted level, rather than compete on the basis of price.
• The national and international markets are more competitive, but they remain a meaningful and reliable source of students for most mid- to high-profile institutions.

STABILITY
• Population growth and rising university participation rates, largely due to increasing educational requirements in the global labour market, provide considerable stability to university enrolments, although local trends may vary notably across regions and influence specific institutions differently.
• However, an aging demographic will have an adverse effect over the long term on institutions with weaker academic profiles and reduced ability to attract international students.
• While they typically increase slowly, operating grants from governments (40% to 60% of total revenue) have historically shown little year-over-year volatility, while expenditures tend to be very predictable, providing significant stability to results and operations.
REGULATION

- Since public universities receive a considerable portion of their funding from public sources, significant components of their operating environments are defined through legislation, regulations and/or policies. These generally relate to the governance structure, degree-granting powers, program offerings, borrowing capacity, government funding and, more importantly, fee-setting autonomy.

- Overall, the legislative and/or regulatory framework pertaining to universities tends to be fair and provides stability to the sector, although the constraints imposed on fee-setting autonomy are limiting. As such, this factor is generally a neutral consideration in the assessment of public universities.

- While the sector must compete for funding with other government priorities (such as health care, which in many jurisdictions is consuming a steadily growing share of budgets), education remains a priority for both the public and governments. This makes governments generally supportive of their institutions and has at times encouraged governments to provide one-time funding or help to institutions facing financial difficulty.
Public Universities Business Risk Rating

**PRIMARY BRR FACTORS**
The BRR grid below shows the primary factors used by DBRS in determining the BRR. While these primary factors are shown in general order of importance, depending on a specific issuer’s business activities, this ranking can vary by issuer.

### Public Universities - Primary BRR Factors

<table>
<thead>
<tr>
<th>Rating</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Academic Profile</strong></td>
<td>• The university is viewed as a flagship institution nationally, making it a first-choice institution.</td>
<td>• The institution has a long history of excellence.</td>
<td>• The institution is fairly new or has failed over the years to establish a reputation beyond its region, making it excessively dependent on its local catchment area to sustain enrolment.</td>
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<tr>
<td></td>
<td>• It is also well-known internationally and frequently referred to in international rankings, translating into very strong student draw, an extremely competitive admission process and pricing power for international students.</td>
<td>• It is a key component of the provincial university network and has successfully developed over the years well-regarded niche disciplines, which help the institution differentiate itself from its competitors.</td>
<td></td>
</tr>
<tr>
<td><strong>Government Funder Rating</strong></td>
<td>• The government has a rating at least in the AA range.</td>
<td>• The government has a rating at least in the “A” range.</td>
<td>• The government has a rating at least in the BBB range.</td>
</tr>
<tr>
<td><strong>Adequacy of Government Funding and Tuition Fees</strong></td>
<td>• Reasonable flexibility is provided to raise fees at a pace exceeding the consumer price index (CPI).</td>
<td>• The government tuition fee policy is stable and permits increases somewhat in line with system cost inflation.</td>
<td>• The fee policy has been inconsistent over the years and significantly constrains tuition fee increases to a pace that is inadequate to meet cost inflation without adequate compensation through government operating grants, resulting in academic revenue growth that is outpaced by expenditures.</td>
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<td></td>
<td>• Government funding is predictable and sufficient to cover system enrolment growth and inflation, with relief provided on an ad hoc basis to address targeted cost pressures (e.g., deferred maintenance and new facilities).</td>
<td>• Government funding remains sufficient to fund enrolment growth in the system, but adjustments for inflationary pressure may only be partial, forcing institutions to exercise spending restraint.</td>
<td></td>
</tr>
<tr>
<td><strong>Location and Catchment Area</strong></td>
<td>• The university is located in one of the country’s major cities, with a dynamic economy and growing population, which helps drive enrolment and adds to the appeal of the institution among out-of-town students.</td>
<td>• The institution is located in a large, growing city or close to major centres, allowing for daily commutes.</td>
<td>• The institution is located in a small region, away from any larger centre and/or with a declining population, or in a market saturated with fierce competition.</td>
</tr>
<tr>
<td></td>
<td>• While there may be other universities serving the region, supply is limited and/or the university is the first-choice institution.</td>
<td>• Competing institutions may be within driving distance, but do not focus on the same niches, maintaining a sound equilibrium between program offering and student demand.</td>
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</tbody>
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<tbody>
<tr>
<td>Size</td>
<td>• The institution is among the largest in the country. • This translates into a comprehensive program offering superior visibility among students across the country, considerable synergies in operations and efficient use of the facilities. • It also provides considerable flexibility to merge and/or restructure programs, if needed.</td>
<td>• The university is of medium size. • This allows for economies of scale in administrative functions and relatively efficient offerings in selective programs.</td>
<td>• The university has fewer than 10,000 FTEs or a student population spread across multiple small campuses and lacks critical mass in most of its programs. • This results in above-average operating costs and limited flexibility to merge or reorganize classes to generate savings, if needed.</td>
</tr>
</tbody>
</table>

The following BRR risk factors are relevant to issuers in all industries (although the relevance of sovereign risk can vary considerably):

**Sovereign Risk**  
The issuer rating may, in some cases, be constrained by the credit risk of the sovereign; in other words, the rating of the country in which the issuer operates generally sets a maximum rating for the issuer. If the issuer operates in multiple countries and a material amount of its business is conducted in a lower-rated country, DBRS may reflect this risk by downwardly adjusting its issuer rating.

**Corporate Governance**  
Please refer to DBRS Criteria: Evaluating Corporate Governance for further information on how DBRS evaluates corporate governance and management.

**Academic Profile**

• Ultimately, the academic profile of an institution determines its brand value. A strong reputation generally translates into stronger and less volatile student demand as it extends the boundaries of the university’s draw beyond its regional catchment area and leads to more successful faculty recruitment and fundraising activities.

• Despite the sharp gain in popularity of academic research in recent years, teaching remains the core mission of universities and the primary driver of university revenue, directly through tuition and grant revenue and indirectly through ancillary operations (e.g., food services and residences).

• In assessing the academic profile of a university, DBRS reviews its history, mission, program offering and academic resources, endeavouring to establish the role and relative importance of the institution regionally, nationally and internationally. Understanding the relative academic strengths and challenges of the institution and the primary factors likely to influence enrolment going forward is paramount in analyzing its financial prospects.

• The trend in student application and enrolment is a particularly insightful indicator of the quality of an institution’s academic profile and is reviewed in relation to the system average and the institution’s enrolment strategy.

• DBRS reviews primary sources of enrolment growth and volatility, application growth trends, student recruitment strategies, regional and national demographic profiles and university participation rates to understand the university’s academic profile in a national and international context.

• DBRS also considers enrolment related statistics such as a university’s offer rate (i.e., per cent of applications that lead to an offer), yield rate (i.e., per cent of offers accepted by students), and the breakdown of undergraduate, graduate and part-time enrolment as a percentage of total enrolment, which provide insight into the institution’s demand profile and potential.

**Government Funder Rating and Relationship Between Institutions and Governments**

• While DBRS rates public universities on the basis of their own merits, the significance of government funding in the revenue base of a university (generally 40% to 60%) makes it hard for these institutions to exceed the credit rating of their main funder. As a result, the government rating becomes a material factor in determining the rating of a public university. Exceeding the rating of the funder would require the institution to have a superior academic profile and substantial uncommitted financial resources,
such as cash on hand, internally restricted endowments or operating reserves (preferably exceeding its
debt burden).

- The close relationship between universities and their governments provides material stability to the
  operating framework and support to ratings in the sector. Significant components of a university’s oper-
  ating environment are defined by legislation, regulations and/or policies.
- Beyond the operating funding and tuition fee frameworks, which are part of DBRS’s primary rating
  factors, key considerations such as the governance structure, degree-granting powers, program offerings
  and borrowing power may also be influenced or determined by governments. DBRS is attentive to the
  operating framework that universities are subject to, with particular emphasis put on the complexity
  and consistency of the framework, as well as the reasonableness of the powers granted to the system.
- DBRS also monitors the relationship maintained by a government with its universities. The extent of
  government oversight warrants special attention in this analysis, and is generally viewed positively by
  DBRS, as it fosters discipline in the system. For example, governments may require that institutions seek
  advanced approval of operating budgets, capital plans and external borrowing.
- Concrete examples of a government financially supporting its institutions when under stress may also
  be important consideration in the analysis, especially for weaker credits.

Adequacy of Government Funding and Tuition Fees

- University funding policies and tuition fee policies often go hand-in-hand, as governments generally
  understand that weakness on one side needs to be offset by increased flexibility on the other since
  operating grants and tuition combined generally account for most of a public university’s revenues.
  Unfortunately, political considerations and/or fiscal challenges may at times distort this relationship and
  temporarily give rise to inadequate funding. For this reason, DBRS also reviews these policies together,
  with considerable emphasis put on consistency, stability and sustainability.
- An adequate university funding framework would be expected to provide funding for system enrolment
  growth and basic inflationary pressures, at the same time instilling spending prudence in the system.
  DBRS also looks for predictability and responsiveness to unexpected system challenges when analyzing
  a government’s funding regime.
- In public university systems, tuition fee regimes are expected to limit fee-setting autonomy. Nonetheless,
  the regime should allow for adequate annual adjustments, especially if annual increases in operating
  grants are consistently inadequate to cover prudently budgeted cost increases.

Location, Catchment Area and Competition

- Although students generally tend to be fairly mobile, an institution’s location may often significantly
  influence its ability to attract students and high-quality faculty members.
- Major cities with a growing population and dynamic economy offer larger and expanding local student
  catchment areas while facilitating interaction with the private sector through, for example, student
  internship, fundraising or research activities. However, some of these benefits may be offset by more
  intense competition to attract better students, as larger cities often have a greater number of post-
  secondary or tertiary institutions.
- The relative proximity of a university to other institutions with similar program offerings may hinder
  student recruitment and introduce volatility in enrolment. For this reason, DBRS also seeks to under-
  stand the factors that differentiate the institution from its closest competitors and the factors likely to
  continue to stimulate student demand and ensure the institution’s existence going forward.
- The issue of competition is usually analyzed in conjunction with other considerations, such as location,
  the program mix and any specializations that may exist at the institution.

Size

- Larger universities are generally believed to have greater flexibility than smaller institutions in absorbing
  declining enrolment, as they can more easily consolidate classes. This also translates into a comprehen-
  sive program offering, superior visibility among students across the country, considerable synergies in
  operations and efficient use of the facilities. In some cases, however, the benefits provided by size may
  be accompanied by inefficiencies resulting from cumbersome management and policies.
ADDITIONAL BRR FACTORS

- The additional BRR factors discussed below may be very important for certain issuers, depending upon their activities, but they do not necessarily apply to all issuers in the sector.

**Expendable Financial Resources and History of Fundraising**

- Uncommitted financial resources can provide considerable flexibility to a university and help reduce borrowing needs for eventual capital projects.
- In assessing the financial cushion carried by an institution, DBRS will exclude investment assets that are committed for near- to medium-term purposes or those for which use is constrained by external parties, such as government research grants or externally restricted endowments. As such, DBRS’s concept of “expendable financial resources” will include operating cash balances, unrestricted short-term and long-term marketable securities and internally restricted endowments, which can generally be “un-endowed” to meet financial obligations, if necessary.
- As part of this assessment, DBRS will also pay attention to the resources allocated to fundraising operations and the success of the university at fundraising, as this provides an indication of the speed at which financial resources can be expected to grow over time or be replenished if drawn for various purposes.
- Fundraising growth potential is closely linked to academic profile, underpinned by the strength of the alumni base, fundraising infrastructure and the success of past campaigns. The relative importance in the revenue base of fundraising, endowment and investment income, as well as the sustainability of the endowment payout ratio and restrictions on the use of fundraising proceeds are important elements considered. DBRS monitors major donations from individuals, governments and corporations for the funding impact on major campus initiatives.

**Labour Relations**

- Labour compensation costs including salaries and wages, pensions and other post-employment benefits represent the largest set of expenditures for public universities, and DBRS closely monitors the affordability and evolution of labour costs over a medium term horizon to assess the impact on a university’s financial position.
- Frequent and prolonged labour disruptions can not only negatively affect cost structures, but also erode the image of a university and adversely affect enrolment trends.
- Important factors considered include the following: historical relationship between the institution and its employee groups, degree of unionization, staffing levels and future requirements, terms of major labour contracts (e.g., salary escalation, expiry date of collective agreements, wage agreements and pension provisions), the negotiation process, and the history of employee labour actions.

**Adequacy of Infrastructure Base**

- The analysis of the infrastructure base of a university may provide considerable insight into the capacity of the institution to pursue its mission and accommodate enrolment growth and into potential capital financing requirements. The review primarily focuses on the capacity of existing facilities in relation to enrolment projections for the foreseeable future, as well as any evidence of deferred maintenance based on third-party assessments.
- Also considered is the approach used by the university to maintain capital assets in a state of good repair and to finance and manage capital projects (e.g., fixed-price contracts and cost recovery from operating units). The purpose of each major project being financed through a debenture issue is carefully analyzed by DBRS, along with the certainty of expected cash flows associated with those projects.
- DBRS monitors the extent of a university’s deferred maintenance needs and backlog, including employing metrics such as the facilities condition index (deferred maintenance-to-asset base replacement costs) to assess the state of the infrastructure base.
Public Universities Financial Risk Rating

PRIMARY FRR METRICS

- The FRR grid below shows the primary FRR metrics used by DBRS to determine the FRR. While these primary FRR metrics are shown in general order of importance, depending upon an issuer’s activities, the ranking can vary by issuer.
- DBRS ratings are primarily based on future performance expectations, so while past metrics are important, any final rating will incorporate DBRS's opinion on future metrics, a subjective but critical consideration.
- It is not unusual for a company’s metrics to move in and out of the ranges noted in the grid below, particularly for cyclical industries. In the application of this matrix, DBRS looks beyond the point-in-time ratio.
- Financial metrics depend on accounting data whose governing principles vary by jurisdiction and, in some cases, industry. DBRS may adjust financial statements to permit comparisons with issuers using different accounting principles.
- Please refer to DBRS Criteria: Financial Ratios and Accounting Treatments – Non Financial Companies for definitions of, and common adjustments to, these ratios in the FRR grid below.
- Liquidity can be a material risk factor, especially for lower-rated non-investment grade issuers. DBRS will consider available sources of liquidity including cash on hand, cash flow, access to bank lines, etc., as well as uses of liquidity such as operations, capital expenditures, share buybacks and dividends for every issuer.
- While market pricing information (such as market capitalization or credit spreads) may on occasion be of interest to DBRS, particularly where it suggests that an issuer may have difficulty in raising capital, this information does not usually play a material role in DBRS’s more fundamental approach to assessing credit risk.

### Public Universities - Primary FRR Metrics

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<tr>
<th>Primary Metric</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
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<tbody>
<tr>
<td>Debt per full-time equivalent (FTE)</td>
<td>&lt; $10,000</td>
<td>$10,000 to $15,000</td>
<td>&gt; $15,000</td>
</tr>
<tr>
<td>Interest coverage</td>
<td>&gt; 2.5x</td>
<td>1.3x to 2.5x</td>
<td>&lt; 1.3x</td>
</tr>
<tr>
<td>Expendable resources* - to debt</td>
<td>&gt; 80%</td>
<td>5% to 80%</td>
<td>0%</td>
</tr>
<tr>
<td>Surplus-to-revenue (five-year average)</td>
<td>&gt; 1%</td>
<td>0% to 1%</td>
<td>Steady deficits</td>
</tr>
</tbody>
</table>

* Including cash on hand, operating reserves and unrestricted or internally restricted endowment assets.
Overall Considerations in Evaluating an Issuer’s Financial Risk Profile

In addition to the information already provided with respect to key financial metrics, the following financial considerations and ratios are typically part of the analysis for the public university industry.

OPERATING PERFORMANCE

- The primary objective of this part of the analysis is to establish the volatility and predictability of major spending items, the adequacy of the financial resources available to the university to fulfill its mission and the ability of the management team to manage operations within its means. As such, DBRS primarily focuses on the institution’s revenue and expenditure bases by core activities (e.g., teaching, research and ancillary services), the framework in place to plan and manage day-to-day operations, the track record of operating results and management’s planning and cost-control efficiency.
- Through this detailed analysis, DBRS also identifies the areas of relatively high operating risk and attempts to develop an understanding of the likely trajectory of operating results for the years to come.

Revenues

- DBRS closely examines the composition and diversification of the revenue base of universities in order to assess the resilience and growth potential of each major revenue source. These include: namely, government grants, tuition fees, ancillary revenues, fundraising and donations and investment income on endowments.
- Given the significance of government funding in the revenue base of public universities (generally 40% to 60%), one could expect ratings on universities to be closely related to those of their sponsoring governments, more so since governments often define key aspects of university operations such as governance structure, fee-setting autonomy, program offerings and, in certain cases, borrowing capacity.
- As such, despite the importance allocated to the government rating in the analysis, the rating on a university is primarily based on the institution’s own merits and may diverge substantially from that of its sponsoring government.
- In addition to direct operating and capital funding, governments set constraints on fee-setting autonomy through regulatory and policy frameworks. DBRS considers the outlook for enrolment and the relative importance of tuition fee revenue, as well as fee levels relative to competing institutions and jurisdictions in assessing revenue potential from student sources.

Expenditures

- As part of the expenditure analysis, DBRS takes a close look at the nature and volatility of major spending items, including labour costs, debt servicing, research, utilities and maintenance and ancillary services. Historical and expected trends are analyzed, along with the management team’s track record of spending discipline and expected ability to control future cost pressures. Total labour costs including salaries and wages, pensions and employee future benefits are critical drivers of overall expense growth at most institutions and are a key area of focus in DBRS expenditure analysis.
- Research spending is an area of interest given the impact of research on a university’s profile and bottom line. The nature and relative importance of research activities, stability and management of related cash flows and the flexibility to manage infrastructure and labour requirements under changing conditions are key considerations given the volatility of research funding.
- The rigidity of other voluntary and mandatory expenditures including utilities, maintenance, student aid and ancillary operations (housing, parking and dining) are other important areas of consideration.
- DBRS also monitors current and projected debt servicing costs in relation to revenues and operating cash flows, as well as the overall stability of interest charges, in order to assess the capacity of the institution to service its debt obligations.
Operating Balance

- The historical operating performance of a university may provide valuable information on the style of its management team, the risk related to its core activities and the challenges likely to be faced by the institution going forward. DBRS analyzes the size and stability of past surpluses, as well as the key factors behind past deficits (if any) to obtain a clearer picture of the trend expected to be followed by operating results and cash flow generation in the years ahead.

- DBRS recognizes that public universities are generally non-profit organizations and, as opposed to corporations, do not seek to maximize their surpluses. Nonetheless, consolidated results should at least be balanced on a fairly consistent basis and management should demonstrate a strong commitment to managing within its means.

- While special circumstances may warrant a shortfall, a track record of repeated deficits could materially damage a university’s credit profile. In such a situation, DBRS would, at a minimum, expect to see a clear and realistic plan to restore fiscal soundness within a reasonable time frame to prevent undue erosion in the credit profile.

- DBRS places emphasis on a university’s operating balance (surplus or deficit) in relation to its total revenue, as well as historical averages, assessing how deviations from a balanced operating position affect financial flexibility and debt sustainability.

Balance-Sheet and Financial Flexibility Considerations

- As part of determining the overall financial risk profile of a public university, DBRS evaluates various other factors to measure the current and projected strength and financial flexibility. The main objective of this section is to evaluate the extent of financial flexibility enjoyed by the institution through its balance sheet and the level of protection provided to bondholders. Accordingly, DBRS pays particular attention to the level of financial obligations carried by the university in relation to the resources expected to be available to fulfill those obligations going forward.

- The review is comprehensive and encompasses a wide range of financial commitments in addition to traditional debt, including leases and post-employment benefit obligations, which are allocated a lower weighting than traditional debt in the analysis. This is the case, for example, for government research funding, which is generally non-discretionary and earned as matching expenditures are incurred. In addition to current debt, DBRS includes in its rating assessment any new leverage expected within a reasonable level of certainty to be incurred by the university over a three- to five-year horizon, highlighting the forward-looking nature of DBRS ratings.

Debt

- A key factor in the assessment of a university’s credit profile, debt is measured and assessed by DBRS in relation to enrolment (i.e., debt per FTE), academic revenue and expendable financial resources. However, DBRS does not assess debt in relation to consolidated revenue, as such a measure is often misleading and subject to distortions from items that may boost revenue without necessarily adding to a university’s financial flexibility. This is the case, for example, for government research funding, which is generally non-discretionary and earned as matching expenditures are incurred. In addition to current debt, DBRS includes in its rating assessment any new leverage expected within a reasonable level of certainty to be incurred by the university over a three- to five-year horizon, highlighting the forward-looking nature of DBRS ratings.

- Debt is only measured as net of assets when those assets are set aside for debt retirement and held with a trustee, which guarantees the integrity of the funds until the maturity of the debt. Otherwise, debt is presented on a gross basis, with the related assets included as part of expendable financial resources. However, DBRS may allocate a lower weighting to debt directly or indirectly serviced by high-quality commercial activities, such as residences or parking facilities.

- In addition to traditional debt, DBRS includes material capital leases and public-private partnerships in its debt metrics.
DBRS also incorporates the following debt-related considerations into its analysis:
• Internal and external restrictions on borrowing activity (e.g., legislation and university policy).
• Debt instruments used (e.g., security, seniority, bullet/amortizing and covenants).
• Debt maturity profile.
• Purpose of existing and new debt.
• Projected impact of capital programs and new debt on cash flow, including projected interest coverage (operating cash flow-to-interest charges).
• Plans to retire debt over time (e.g., internal sinking fund).

**Debt Servicing**
• Interest charges are also an important consideration in the analysis and are measured in relation to revenues and operating cash flows in order to assess the affordability of outstanding debt. A look into the debt structure and the university’s debt management strategy also helps assess the potential volatility of the servicing requirements. More particularly, analysts examine the maturity structure of the debt stock and its sensitivity to changes in interest rates.
• An institution’s interest coverage ratio is a key metric tracked by DBRS to assess capacity to meet annual debt servicing requirements with cash generated from operations.
• In keeping with the forward-looking nature of DBRS ratings, analysts will generally seek to develop a three-to five-year outlook for debt and debt-servicing requirements.

**Other Commitments and Contingencies**
• Other financial obligations may also weigh down the credit profile of a university if they represent a fairly certain future draw on cash flow. The major types of other financial obligations incorporated into DBRS analysis include the following:
  • Pension plan deficits (e.g., nature of plan, adequacy of contributions and trend of deficiencies) and unfunded post-employment benefits.
  • Capital commitments.
  • Other off-balance-sheet liabilities (e.g., operating leases, lawsuits and derivatives).
• While generally less constraining than debt, the other types of financial obligations are important considerations in the credit analysis and are allocated varying weightings, reflecting the materiality, certainty and timing of the associated potential cash flows.
• For example, pension plan liabilities will warrant a greater weighting than post-employment benefit liabilities, as employers often have some flexibility to unilaterally modify post-employment benefits for employees who are still active, if necessary, which is not the case for pension benefit liabilities.
• Of the above, DBRS pays particular attention to unfunded employee benefit liabilities, which it tracks with debt (debt and unfunded employee benefit liabilities) on a nominal and per-FTE basis, as they provide a good indicator of potential pressure on future cash flows.

**Financial Resources**
• Although DBRS incorporates all types of financial resources into its credit assessments of universities, two categories of liquid assets warrant particular attention: short-term unrestricted liquidity and expendable financial resources. DBRS believes these two measures best reflect the flexibility a university has to meet short-term liquidity requirements and weather longer-term unforeseen adverse developments.
• DBRS’s short-term liquidity measure includes cash balances and short-term, high-quality securities held by a university for operating purposes. Expendable financial resources, on the other hand, constitute a broader measure of financial flexibility that encompasses short-term sources of liquidity as well as longer-term assets, which have more volatile realizable value.
• In calculating such indicators, DBRS will generally include operating cash balances, unrestricted short-term and long-term marketable securities and internally restricted endowments, as those can generally be “un-endowed” to meet financial obligations, if necessary. However, assets subject to external restrictions or whose realizable value appears too uncertain are excluded, since the objective is to obtain a conservative and reliable indicator of the resources that can be accessed within a reasonably short time frame to meet unexpected financial obligations.
As a result, items such as externally restricted endowments and non-core real estate assets will be excluded from DBRS’s primary measures of financial flexibility, but will usually still carry positive implications for the overall credit profile. Below are the primary sources of financial resources scrutinized by DBRS.

- Short-term liquidity (unrestricted cash, short-term marketable securities)
- Endowments (externally vs. internally restricted, management policies, investment performance)
- Other resources (unrestricted investments, non-core real estate, business partnerships and intellectual property)

Typical balance-sheet ratios include the following:

- Total debt per FTE.
- Debt and other commitment (e.g., pension liabilities) per FTE.
- Debt service coverage ratio (operating cash flow-to-interest charges).
- Expendable financial resources-to-total debt.
- Endowment assets per FTE.
Blending the BRR and FRR into an Issuer Rating

- The final issuer rating is a blend of the BRR and FRR. In most cases, the BRR will have greater weight than the FRR in determining the issuer rating.
- At the low end of the rating scale, however, particularly in the B range and below, the FRR and liquidity factors play a much larger role and the BRR would therefore receive a lower weighting than it would at higher rating levels.

Rating the Specific Instrument and Other Criteria

- The issuer rating (which is an indicator of the probability of default of an issuer’s debt) is the basis for rating specific instruments of an issuer, where applicable. DBRS uses a hierarchy in rating long-term debt that affects issuers that have classes of debt that do not rank equally. In most cases, lower-ranking classes would receive a lower DBRS rating. For more detail on this subject, please refer to the general rating information contained in the DBRS rating policy Underlying Principles.
- For a discussion on the relationship between short- and long-term ratings and more detail on liquidity factors, please refer to the DBRS policy Short-Term and Long-Term Rating Relationships and the criteria Commercial Paper Liquidity Support Criteria for Corporate Non-Bank Issuers.
- Guarantees and other types of support are discussed in Guarantees and Other Forms of Explicit Support.
- For further information on how DBRS evaluates corporate governance, please refer to DBRS Criteria: Evaluating Corporate Governance.