MOODY'S INVESTORS SERVICE

CREDIT ANALYSIS

University of Ottawa

Ottawa, Ontario, Canada

Table of Contents:

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This Credit Analysis provides an in-depth discussion of credit rating(s) for the University of Ottawa and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website.

Summary Rating Rationale

The University of Ottawa's Aa1 debt rating reflects the university's strong balance sheet and modest debt burden, supported by a history of positive operating outcomes. Adherence to the university's Liability Management Policy is expected to ensure the continuation of a modest debt profile. The rating also reflects the University of Ottawa's strong market position as a research-intensive, bilingual university. The university's multi-year budgetary process facilitates implementation of measures required to balance its budget over the medium term as the university manages growing expenditure pressures in the context of a slower pace of revenue growth.

Rating Outlook

The outlook is stable.

Issuer Overview

The University of Ottawa is a medical doctoral, bilingual university located in the capital of Canada. The university offers a full range of academic and professional programs in 10 faculties, including arts, science, management, engineering, medicine and law. The University of Ottawa, like other universities in the province of Ontario, was incorporated by an act of the provincial legislature.

Key Rating Factors

Market Position

Bilingual, Research-Intensive University Benefits from Location in Nation's Capital

The university's status as Canada's premier bilingual university as well as its location in the nation's capital differentiates it from other institutions and, as such, enhances its market position. The university's official bilingualism does not mean that students have to be bilingual to be admitted, but that most courses and programs are offered in both languages. The University of Ottawa's student body is approximately two-thirds English-speaking and one-third French speaking and 75% of professors are bilingual.

Enrolment at the university increased rapidly since the beginning of the decade, growing from roughly 26,000 full time equivalents (FTEs) in the 2001-02 academic year to over 37,000 in 2008-09. Growth is driven by the institution's academic reputation and positive demographic trends in the Ottawa region. Enrolment is expected to increase modestly over the medium term reflecting growth in graduate students, owing to a provincial government funding policy emphasis and also due to the university's own strategy to enhance research activities. Graduate students currently account for an important 28% of the student body (on an FTE basis). The undergraduate population is forecast to remain relatively stable as the university reaches its "steady-state" size.

The University of Ottawa is one of Canada's most research-intensive universities and has substantial research programs in several faculties, most notably, the faculties of medicine and health sciences. Through these faculties, and their relationship with the university's affiliated hospitals, the university has been successful in attracting research funding from the federal government's granting councils and other sources. Research grants and contracts reached C$146 million in 2008-09, up from C$98.2 million in 2001-02; however the university also benefits from research grants provided to affiliated hospitals which amounted to an additional C$114 million in grants awarded in 2008/09.

Government Relationship

Ontario Universities Retain High Degree of Autonomy

While the province is ultimately responsible, constitutionally, for the delivery of post-secondary education, the University of Ottawa, like other Ontario universities, operates at arms-length from the province. The provincial government establishes broad strategies and targets for each university, provides operating grants and has the authority to control tuition fees, but each university retains autonomy to carry out its activities. This "hands-off" approach to the university sector in Ontario is unlike that in some other Canadian provinces, such as British Columbia and Quebec, where the level of provincial control and oversight is considerably greater.

Province Remains Mainstay of Funding; But Some Easing Anticipated

The provincial funding environment for Ontario universities improved measurably over the past several years following a challenging period in the early 1990s to 2005, when the provincial government reduced its support for the post-secondary education sector. While lessened support was partially offset by allowed increases in tuition the university sector was still faced with financial shortfalls that necessitated expenditure adjustments by all institutions.

In 2005, as part of its policy goal to increase domestic participation in higher education the province enhanced funding substantially for post-secondary education. The government entered into multi-year agreements with individual universities in order to promote access, quality and accountability in higher education. More recently the province has placed greater emphasis on increasing graduate enrolment by expanding funding for these programs. As a result of these initiatives, grants to post secondary institutions rose at a healthy 7.8% a year on a compound annual growth rate (CAGR) basis from 2004/05 through 2008/09. At the University of Ottawa, government grants for operations grew at a compound annual growth rate of 8.6% over the same period.

As a result of the deterioration in the province's financial performance in the wake of the severe economic downturn in Ontario, the pace of operating grants is expected to slow over the medium term. In 2009/10 the province budgeted for a small decrease in total post secondary grants of 2.7%. While the growth in operating and capital grants to Ontario universities may slow, we do not anticipate that grants will be reduced dramatically.

Tuition Regulation Framework Offers Some Flexibility

The provincial tuition regulation framework offers some fiscal flexibility. Since 2006-07, the province has allowed tuition increases of up to 5% a year under a multi-year agreement which expires in 2009/10. While tuition increases of this magnitude have not been sufficient to keep pace with rising academic salaries and benefits, the combination of rising government grants and modest tuition increases provides enough flexibility for universities in Ontario to manage pressures and balance their operating budgets.

While the government has not indicated what regulations would be in place after 2010, Moody's does not anticipate significant changes to the current framework.

Governance and Management

Prudent Financial Management

The university's Board of Governors is responsible for the management, administration and financial affairs of the university. The University's Senate is responsible for the educational policy of the university—including the establishment of academic faculties and departments, the granting of degrees and academic policies on admission, scholarships and bursaries—but subject to Board approval to the extent that financial matters are concerned. The Board is composed of 31 members, of which 4 are provincial appointees; other board members include Senate appointees (2) and Alumni Association members (2). The University of Ottawa's academic mission is clearly articulated and the Board possesses the tools necessary to oversee and monitor effectively management's activities.

The university's internal financial management policies, including multi-year planning, reflect a fiscally conservative approach ensuring consistency with the university's strategic plan and allowing for pressures to be identified and addressed early. The Board, on the advice on the university's treasurer and external consultants, makes broad asset allocation decisions with respect to university's endowment and approves the appointment and removal of external money managers. The portion of the university's working capital not currently needed is also invested by external managers, subject to the university's investment policy for short-term assets. Moody's views this delegation of investment management responsibilities as a credit positive.

A liability management policy (discussed below) was adopted in 2007; it specifies limits for debt accumulation and minimum requirements for liquidity. This policy illustrates the administration's commitment to prudent financial management and we consider the adoption of this policy as a credit positive.

Operating Performance

Multi-Year, Prudent Budgetary Practice Enhances Flexibility

The University of Ottawa relies on a rolling three-year operating budget plan that helps provide flexibility to meet challenges as they arise; this is particularly important as the university faces continued cost pressures in the context of slower revenue growth. A self-imposed policy of never budgeting for an operating deficit also ensures discipline. To meet its budget targets, the university follows a number of internal policies and controls, including using conservative revenue estimates and expense assumptions and consistently monitoring departmental activities throughout the year to ensure any over-expenditures or revenue shortfalls are identified and addressed before the fiscal outcome is jeopardized.

These practices have helped underpin the university's annual surpluses and positive funds from operations over the past several years despite facing cost pressures that are prevalent throughout the sector. From 2002/03 through 2007/08 the adjusted operating margin averaged 10.1% of revenues annually. Similarly funds from operations have been positive averaging 13.2% annually from 2002/03 through 2007/08.

Margins Narrow; But Policy Response Expected to Balance Accounts over Medium Term

In 2008/09, operating margins narrowed to 3.4% of revenues in part due to the negative impact of the global economic crisis on the university's investment income, but also due to rising salaries that have been granted as the university strives to remain competitive in attracting high-quality faculty. Results reflected minor growth in revenues—growing by a mere 0.5%, or 2.5% when the impact of investment losses is excluded, over the prior year--while expenditures rose by a higher 8.8%. A sharp drop in investment income did not have a significant impact on financial operations as this source of revenue typically comprises less than 3% of operations. A healthy rise in tuition and fees-up by 5.9% to reflect a 5% rise in tuition and increased enrolment of 2.8%--and a slower pace of provincial grants--up by 2.1%--however, were insufficient to meet rising expenditures driven by a 13% rise in salaries and benefits reflecting wage outcomes and new hiring. Funds from operations narrowed to 3.3% of revenues reflecting similar trends.

The university's expenditures are expected to remain under pressure as it seeks to enhance student services and increase student assistance while its ability to raise incremental revenues remains constrained. However, the university's conservative fiscal policies and inherent budget flexibility are expected to underpin balanced accounts over the medium term. A special executive committee has been set up to identify cost savings and additional revenues to offset projected short-falls in 2010/11. In 2009/10, the university plans to finance an estimated operating deficit of $13 million through internal reserves.

Debt Profile

Low Debt Burden

The university has largely financed its capital improvements with internal funds leading to a comparatively low debt burden, measuring 29% of revenues in 2009. The debt burden has declined from a peak of 48.5% in 2003 when the university issued its sole debenture of $150 million.

While the University of Ottawa believes that it is facing a campus space shortage and has identified additional capital projects that it would eventually like to undertake, it is conservative in its approach to capital planning and proceeds only as funding is secured. The university's five-year capital plan (2009-2013) identifies five projects totaling C$150 million and, as such, is not overly aggressive. The university's base case assumption when developing its capital plan is to borrow 50% of total capital requirements; however, the university has built internal reserves to finance approved capital projects and has been awarded senior government grants in the amount of C$95 million as part of the federal government's economic stimulus program which should be sufficient to avoid borrowing over the medium term.

The university's Liability Management Policy was developed over the past few years and was approved by the Board in 2007. The policy's goal is to ensure that debt ratios remain modest as the university considers further debt issuance in support of its capital plan. The policy establishes guidelines for a number of financial ratios; management must report the relevant ratios to the Board on at least an annual basis, including a five-year forecast, in order to identify deterioration of the outlook in advance and take appropriate action. As of 2008, ratios were well in compliance with policy requirements and forecasts did not indicate a potential deterioration. We view adoption of the university's Liability Management Policy as testament to the university's prudent and conservative financial management and as a safeguard against a reversal of its recent improvements in financial position.

Balance Sheet Strength

Financial Assets Provide Sizeable Cushion For Debt Outstanding

While the absolute amount of the university's endowment assets (C$129.1 million at April 30, 2009) is modest compared to other similarly sized Canadian institutions, growth through 2007/08 had been strong reflecting an increased emphasis on fundraising. From 2002/2003 through 2007/08, endowment assets expanded at a compound annual growth rate of roughly 20%. However in 2008/09 as a result of the global financial crisis investment losses of 18%--only partially offset by new donations--reduced the size of the endowment from C$141.1 million to C$129.1 million. We do not consider this to represent a permanent impairment to the university's balance sheet, nor do we expect this to have a measurable impact on the university's near-term operating performance or financial flexibility.

Given the university's limited fundraising experience and large alumni base, untapped potential is considered high and endowment assets are expected to continue to experience strong growth. The university recently completed a C$200 million fundraising campaign and will be considering another campaign soon

Total cash and investments of the university reached C$576 million at April 30, 2009. Net cash and investments have strengthened significantly in recent years and measured C$462.0 million or 2.4 times net-direct-debt at April 30, 2009, up from C$164.9 million or 0.8 times net-direct-debt at April 30, 2003. These improvements in liquidity and balance sheet strength represent a positive credit development and provide an additional measure of safety to bondholders.

The university's defined benefit pension plan recorded a surplus of C$112.2 million at April 30, 2009, on total plan assets of C$1 billion. The surplus increased from the C$61.7 billion recorded in the prior year despite the impact of investment losses on the fund's assets due to a reduction in the overall liability as the result in an increase in the discount rate from 6.25% to 8.75%. However, the university anticipates that an unfunded liability will emerge this year as the discount rate is likely to be lowered. However, it is anticipated that a recovery in plan assets will offset the increase in the discount rate by 2010/11, at the time of the next required actuarial assessment. The university has set aside reserves of $15 million if improvements are less than anticipated.

Rating History

University of Ottawa

DATE	RATING
November 2008	Aa1
March 2003	Aa3

Annual Statistics

University of Ottawa

DEBT STATEMENT (AS AT 30/04, C$ MILLIONS)	2004	2005	2006	2007	2008	2009
Mortgages, Loans and Capital Leases	63.3	62.0	60.5	59.0	54.6	52.9
Debentures	150	150.0	150.0	150.0	150.0	150.0
Total Direct Debt	**213.3**	**212.0**	**210.5**	**209.0**	**204.6**	**202.9**
Less: Sinking funds	6.0	7.2	8.6	10.0	13.1	13.1
Net Direct Debt	**207.3**	**204.8**	**202.0**	**199.0**	**191.5**	**189.9**

DEBT TRENDS (AS AT 30/04)	2004	2005	2006	2007	2008	2009
Net Direct Debt per Student (C$, per FTE)	6,784	6,319	5,858	5,581	5,348	5,110
Net Direct Debt as a % of Revenue [1]	43.3	38.1	35.4	31.9	29.1	28.0

[1] Revenue is net of scholarship expenses and adjusted to smooth investment returns.

MARKET DEMAND TRENDS	2004	2005	2006	2007	2008	2009
Total Enrolment (FTE)	31,632	32,804	34,963	36,195	37,207	37,480
Undergraduate Students as a % of Total (FTE Basis)	75.8	75.8	75.5	73.7	71.9	71.6

STATEMENT OF OPERATIONS (YEAR ENDING 30/04, C$MILLIONS)	2004	2005	2006	2007	2008	2009
Revenue						
Government Grants for Operations	195.2	207.9	237.9	281.0	283.6	289.4
Tuition Fees	150.1	159.0	170.3	182.2	193.2	204.6
Grants and Contracts	103.7	136.1	126.0	125.0	144.3	146.3
Investment Income (Loss)	14.4	14.1	15.6	18.8	24.8	3.8
Donations	8.8	8.8	8.1	9.6	11.2	9.9
Other	41.1	44.7	50.4	50.4	48.8	48.1
Total Revenue	**513.3**	**570.5**	**608.2**	**667.0**	**705.9**	**702.1**
Expenses						
Salaries and Benefits	285.3	315.4	333.8	360.2	381.8	431.6
Materials and Supplies	57.2	66.3	66.7	65.1	70.9	74.5
Scholarships, Fellowships and Bursaries	31.6	32.9	38.1	44.4	48.1	49.0
Amortization of Capital Assets	29.5	31.5	32.4	31.5	33.8	38.0
Interest Payments	14.4	14.2	14.1	13.8	14.3	14.3
Other	49.9	67.4	64.2	62.6	97.5	95.5
Total Expenses	**467.9**	**527.6**	**549.4**	**577.5**	**646.2**	**702.9**
Employee Future Benefits	(13.6)	7.1	0.9	13.9	(7.6)	17.6
Net Income (Loss)	**31.8**	**49.9**	**59.8**	**103.4**	**52.1**	**16.9**
Adjustments						
Revenue [1]	478.6	536.9	570.9	624.2	657.9	677.1
Expenses [2]	436.3	494.7	511.2	533.2	598.2	653.9
Adjusted Net Income (Loss)	**42.3**	**42.1**	**59.7**	**91.0**	**59.7**	**23.2**
Funds From Operations	61.4	59.0	75.4	105.8	78.7	22.3
Free Cash Flow	20.2	18.7	58.6	18.0	51.6	2.8

[1] Revenue is net of scholarship expenses and adjusted to smooth investment returns.

[2] Net of scholarship expenses.

FINANCIAL TRENDS (YEAR ENDING 30/04)	2004	2005	2006	2007	2008	2009
Provincial Funding as a % of Revenue [1]	40.8	38.7	41.7	45.0	43.1	42.7
Net Tuition as a % of Revenue [1] [2]	24.8	23.5	23.2	22.1	22.1	23.0
Interest Expense as a % of Revenue [1]	3.0	2.7	2.5	2.2	2.2	2.1
Debt Service as a % of Revenue [1]	3.3	2.9	2.7	2.5	2.8	2.4
Total Gift Revenue (C$ Millions) [3]	11.9	21.5	17.5	23.7	31.1	10.8
Funds From Operations as % of Revenue [1]	12.8	11.0	13.2	16.9	12.0	3.3
Annual Operating Margin (%) [1]	8.8	7.8	10.5	14.6	9.1	3.4
Average Operating Margin (%) [1]	6.0	6.9	9.1	11.1	11.4	8.9

[1] Revenue is net of scholarship expenses and adjusted to smooth investment returns.

[2] Tuition fees are net of scholarship expenses.

[3] Includes both donations recorded as revenue and as direct additions to endowments.

University of Ottawa

CONSOLIDATED BALANCE SHEET (AS AT 30/04, C$ MILLIONS)	2004	2005	2006	2007	2008	2009
Assets						
Cash and Short-term Investments	271.2	271.0	335.1	345.8	359.5	317.4
Accounts Receivable	78.0	85.7	75.9	81.9	82.6	79.1
Investments	119.2	151.8	158.3	187.9	230.6	258.7
Capital Assets	415.0	460.6	504.3	591.4	624.1	649.7
Other	103.1	110.6	111.9	127.2	121.3	138.9
	986.6	**1,079.7**	**1,185.4**	**1,334.3**	**1,418.1**	**1,443.8**
Liabilities						
Accounts Payable and Accrued Liability	31.9	40.9	60.9	55.1	50.6	65.3
Deferred Contributions	142.0	139.5	141.0	158.1	190.5	192.8
Long-term Debt and Debentures	212.0	210.5	209.0	204.6	214.3	217.6
Deferred Capital Contributions	160.9	184.1	196.6	208.4	207.5	216.1
Other	1.3	1.4	1.5	4.4	1.6	1.7
	548.2	**576.5**	**609.1**	**630.6**	**664.5**	**693.5**
Net Assets						
Unrestricted	1.7	1.1	2.3	3.2	2.7	2.2
Internally Restricted	100.8	135.8	183.6	242.5	282.7	264.6
Equity in Capital Assets	168.0	175.0	183.9	209.6	214.7	224.3
Endowments						
Internally Restricted	5.9	7.3	8.8	13.9	15.1	15.2
Externally Restricted	63.8	78.9	91.7	114.6	126.0	113.9
Restricted for Employee Future Benefits	98.1	105.1	106.1	120.0	112.4	130.0
	438.4	**503.2**	**576.4**	**703.7**	**753.6**	**750.3**

BALANCE SHEET TRENDS (AS AT 30/04)	2004	2005	2006	2007	2008	2009
Total Cash and Investments (C$ Millions)	390.5	422.8	493.4	533.7	590.1	576.1
Total Cash and Investments per FTE (C$)	12,345	12,888	14,111	14,746	15,860	15,160
Net Cash and Investments (C$ Millions) [1]	199.9	238.9	314.9	383.6	464.0	462.2
Net Cash and Investments-to-Net-Direct-Debt (x)	1.0	1.2	1.6	1.9	2.4	2.4
Net Cash and Investments per FTE (C$)	6,321	7,282	9,007	10,597	12,472	12,162
Net Cash and Investments-to-Operations (x)	0.5	0.5	0.6	0.7	0.8	0.7

[1] Total cash and investments net of externally restricted endowments and unspent debenture proceeds.

Moody's Related Research

Credit Opinion:

» Ontario, Province of, November 2009

Special Comments:

» Global Recession and Universities: Funding Strains to Keep Up with Rising Demand, June 2009 (117983)

» Canadian Provinces Face Challenging Conditions, February 2009 (114544)

Statistical Handbook:

» Non-US Regional and Local Governments, December 2009 (121370)

Rating Methodologies:

» Methodology for Rating Public Universities, August 2007 (103498)

» The Application of Joint-Default Analysis to the Canadian University Sector, December 2008 (96859)

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