Credit Opinion: University of Ottawa, Canada

Ontario, Canada

Ratings

<table>
<thead>
<tr>
<th>Category</th>
<th>Moody's Rating</th>
<th>Outlook</th>
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<tr>
<td>Senior Unsecured - Dom Curr</td>
<td>Aa2</td>
<td>Stable</td>
</tr>
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Contacts

<table>
<thead>
<tr>
<th>Analyst</th>
<th>Phone</th>
</tr>
</thead>
<tbody>
<tr>
<td>Michael Yake/Toronto</td>
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<td>Kathrin Heitmann/Toronto</td>
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<tr>
<td>David Rubinoff/Moody's Investors Service EMEA LTD</td>
<td>44.20.7772.5454</td>
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</tbody>
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Key Indicators

University of Ottawa, Canada
(As of April 30)

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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<tbody>
<tr>
<td>Provincial Funding as a % of Revenue [1]</td>
<td>44.0</td>
<td>45.3</td>
<td>45.5</td>
<td>44.9</td>
<td>42.9</td>
</tr>
<tr>
<td>Net Tuition as a % of Revenue [1][2]</td>
<td>23.2</td>
<td>23.6</td>
<td>25.2</td>
<td>27.8</td>
<td>28.1</td>
</tr>
<tr>
<td>Interest Expense as a % of Revenue [1]</td>
<td>1.8</td>
<td>1.7</td>
<td>1.6</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Funds from Operations as a % of Revenue</td>
<td>9.4</td>
<td>9.8</td>
<td>7.1</td>
<td>6.8</td>
<td>8.2</td>
</tr>
<tr>
<td>Net Direct Debt as a % of Revenue [1]</td>
<td>25.0</td>
<td>22.5</td>
<td>18.3</td>
<td>17.3</td>
<td>15.7</td>
</tr>
<tr>
<td>Net Cash and Investments to Net-Direct-Debt (x times)</td>
<td>2.9</td>
<td>3.1</td>
<td>3.7</td>
<td>3.8</td>
<td>4.1</td>
</tr>
</tbody>
</table>


Opinion

SUMMARY RATING RATIONALE

The Aa2 rating for the University of Ottawa reflects the university’s strong balance sheet, modest debt burden and a history of positive operating outcomes. Although the university has faced growing expenditure pressures within a context of a slower pace of revenue growth, the university’s multi-year budgetary process has allowed management the vision required to implement measures conducive to achieving balanced budgets. The rating also reflects the university’s strong market position as a research-intensive, medical/doctoral, bilingual university.

National Peer Comparison

The University of Ottawa is rated in the upper band of the rating range of Canadian universities, whose ratings span the range Aa1-A3. The University of Ottawa’s position relative to peers reflects lower-than-average debt and debt service levels, high proportion of graduate students and substantial liquidity relative to debt metrics. As with other Canadian-rated universities, pressures from restrictions to provincial funding are leading to greater difficulty in balancing budgets.

Credit Strengths
Credit strengths for the University of Ottawa include:

- Low debt and debt service levels expected to continue
- Strong balance sheet providing substantial liquidity
- History of positive operating margins and funds from operations

Credit Challenges

Credit challenges for the University of Ottawa include:

- Financial pressures arising from provincial higher education framework, expenditure growth rates
- Important pension plan liability

Rating Outlook

The outlook is stable.

What Could Change the Rating - Up

Increased provincial funding and greater flexibility to set tuition fees, combined with continued strengthening of the university’s balance sheet could, over time, apply upward pressure on the university’s rating.

What Could Change the Rating - Down

A loss of fiscal discipline, within a context of slowing revenue growth and sustained upward pressure on salaries and benefits, which leads to sustained deficits could exert downward pressure on the rating. An inability to address the unfunded pension liabilities, which will place more pressure on the university’s financial resources, could also place downward pressure on the rating.

Issuer Profile

Located in Canada's capital, the University of Ottawa is a bilingual medical/doctoral university giving it a niche market position. 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 is one of Canada's most research-intensive universities and has notable research programs in several faculties. The university experienced considerable growth in enrolment during the past decade, which also necessitated the undertaking of several significant capital projects on campus. Enrolment exceeds 45,000 full-time equivalent (FTE) students.

The University of Ottawa, like other universities in the province of Ontario, was incorporated by an act of the provincial legislature. 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. While the Ontario Ministry of Training, Colleges and Universities monitors developments at individual universities and demands that universities be accountable, the "hands-off" approach to the university sector in Ontario is unlike that in some other Canadian provinces, such as Quebec and British Columbia, where the level of provincial control and oversight is considerably greater.

DetaiLd RatIng coNsiDeRatiOns

The rating assigned to debt issued by the University of Ottawa combines (1) a baseline credit assessment (BCA) for the university of aa2, and (2) a high likelihood of extraordinary support coming from the Province of Ontario (Aa2, negative outlook) in the event that the university face acute liquidity stress.

Baseline Credit Assessment

LOW DEBT AND DEBT SERVICE LEVELS EXPECTED TO CONTINUE

The University of Ottawa has a comparatively low debt burden, which measured 15.7% of adjusted revenues as of April 30, 2014. After issuing a CAD150 million debenture in 2003 to fund the expansion of campus infrastructure, the debt burden has fallen slowly but steadily since. Upon issuance of the 40-year debenture, the university created a sinking fund, which had a value of CAD31.3 million as of April 30, 2014. The low level of debt also
ensures that debt service remains highly manageable for the university. In 2013-14, interest expense consumed a low 1.4% of revenues.

The university has a limited number of capital projects either in progress or slated to begin. Among these projects are a new residence that is scheduled to be completed for the Fall 2015 session and renovations to a science building. Although these projects are moving forward without the need for debt financing, the university has recently revised its application of its financing policy, raising the debt limit to CAD120 million. It is our understanding that this limit was not raised necessarily to allow for the higher level of borrowing, but merely to reflect the university's improved ability to manage a larger debt level. The university has a number of planned projects that continue to need financing and we expect debt to rise over the medium-term to support these projects, although debt levels and debt servicing should continue to be consistent with the rating.

STRONG BALANCE SHEET PROVIDING SUBSTANTIAL LIQUIDITY

The University of Ottawa has demonstrated strong financial management through the growth of their net cash and investments. At April 30, 2014, net cash and investments, which exclude externally restricted endowments, totaled CAD579.3 million. This level of net cash and investments represented 4.1 times net direct debt, providing ample liquidity and a measure of security to debenture holders. Although debt may increase in the medium-term, it is anticipated that liquidity levels will continue to offer a significant level of security for bondholders.

HISTORY OF POSITIVE OPERATING MARGINS AND FUNDS FROM OPERATIONS

With the exception of 2012/13 when the university posted a net loss of CAD1.5 million, the University of Ottawa has a strong record of recording positive financial results. In the past few years, however, budgeting for balanced results has become more difficult as funding from the province has slowed and the current tuition framework allows for only a 3% annual increase to undergraduate tuition levels. In 2013/14, the university was able to achieve a surplus largely due to stronger than anticipated investment returns; a similar outcome is likely to be repeated for 2014/15. However, on a Moody’s-adjusted basis, which makes adjustments to the university’s annual fiscal outcomes to smooth the impact of investment returns and remove scholarships, fellowships and bursaries from both revenues and expenses, reflecting the “flow-through” nature of these expenses, the university posted an adjusted net loss of CAD3.5 million in 2013/14. This follows an adjusted net loss of CAD5.6 million in 2012/13. This provides an indication to the degree that the university is facing increasing pressures, as discussed below.

To meet its targets, the university follows a number of internal policies and controls, including using a rolling three-year budget plan, which incorporates conservative revenue estimates and expense allocations, as well as 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 ability to minimize the impact of certain budgetary constraints and position the university to generate positive funds from operations during a period which other Ontario universities posted negative financial outcomes.

We anticipate that the University of Ottawa will be able to maintain a balanced budget in 2015/16. Ongoing funding pressures will be mitigated by the university’s ability to increase tuition and fees where possible as benefit from structural changes to pension financing. We will continue to watch the university’s operating outcomes over the medium-term to ensure that positive outcomes remain achievable.

PRESSURES ARISING FROM PROVINCIAL HIGHER EDUCATION FRAMEWORK, EXPENDITURE GROWTH RATES

As the province has a lengthy return to balanced budgets, expected for 2017/18, government grants to universities have been targeted as part of the provincial government’s attempt to reduce overall expenditures. Certain changes, such as the move to a two year education program from a one year, without additional funded spaces, result in greater pressure for universities. Despite the slower growth in government funding, it continues to represent the majority of the universities revenues once government research funding and capital grants are also taken into consideration. Given the restriction on other sources of funding, pressures on government funding are not easily offset.

The current tuition framework that is in place until 2016/17 allows for a maximum annual increase of 3% to undergraduate tuition. Overall, government actions have helped restrict revenue growth, which has not been sufficient to offset the university’s expenditure growth. Over the period 2009/10-2013/14, the compound annual growth rate (CAGR) of revenues measured 5.4%, while the CAGR for expenditures was 6.5%. With pressures expected to persist, the university is looking at targeting more international students and graduate students, both of
which produce higher tuition revenue than undergraduate students as well as finding further efficiencies among its departments.

Although we anticipate that the University of Ottawa will be able to adjust to pressures and produce balanced budgets, the challenge is notable. It is expected that the university faces adjustments of between CAD20 - CAD30 million in 2015/16 and 2016/17 to achieve balanced budgets. Some of these challenges are associated with the provincial funding framework, while others are at the university’s discretion, such as the commitment outlined in its Destination 2020 plan to increase faculty members and increase pay-as-you-go capital financing. Budget 2015/16 is expected to incorporate a number of measures, some of which are structural while others will be one-time to help produce a balanced budget. With enrolment levels expected to be stable over the medium-term, the university will have difficulty raising revenue above levels allowed by the current tuition framework. We will continue to monitor the university’s progress at establishing recurring initiatives that will promote balanced budgets in the future.

IMPORTANT PENSION PLAN LIABILITY

The university’s pension fund position deteriorated in recent years, with the emergence of a solvency deficit in addition to a growing unfunded liability. Although the unfunded pension liability improved in 2014 as a result of strong investment return, it still measured CAD367.9 million on an accounting basis as of April 30, 2014. Changes to the accounting treatment of pensions, beginning in 2015, will apply the same discount rate to accounting assumptions that is used for actuarial assumptions (in 2014, the accounting assumption discount rate was 4.60%, the actuarial assumption rate was 6.25%). The rise in the accounting discount rate will reduce the pension liability considerably and reduce future year over year volatility in the assumptions. The solvency deficit was eliminated, although we expect it to return with future valuations as new assumptions are incorporated. The unfunded liability is equivalent to 41.1% of adjusted revenues, an improvement of the 68.3% level recorded a year prior.

The university is working within the province’s pension relief plan which allows a reduction in the immediate requirement to resolve solvency concerns and lower special payments for the ongoing concern deficit. Nonetheless, the university continues to need make special payments towards the pension plan which will result in additional cost pressures and provide other challenges as the university attempts to record balanced financial results. Given the recent fluctuations in the pension liability, owing to strong returns and updated mortality tables and other assumptions, we will continue to monitor the university’s progress at establishing a long-term plan to reduce this contingent liability.

Extraordinary Support Considerations

Moody’s assigns a high likelihood of extraordinary support from the Province of Ontario (Aa2, negative outlook), reflecting Moody’s assessment of the perceived risk to the province’s reputation if any Ontario university were to default.

Moody’s also assigns a very high default dependence between the University of Ottawa and the Province of Ontario, reflecting the university’s and the province’s joint exposure to prolonged economic shocks. It also reflects the university’s reliance on provincial government grants for a sizeable portion of its overall revenues.

ABOUT MOODY’S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody’s National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody’s global scale ratings in that they are not globally comparable with the full universe of Moody’s rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a “.nn” country modifier signifying the relevant country, as in “.za” for South Africa. For further information on Moody’s approach to national scale ratings, please refer to Moody’s Rating Implementation Guidance published in June 2014 entitled “Mapping Moody’s National Scale Ratings to Global Scale Ratings.”

The Moody’s Global Scale rating for issuers and issues allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Baseline Credit Assessment

Baseline credit assessments (BCAs) are opinions of entity’s standalone intrinsic strength, absent any
extraordinary support from a government. Contractual relationships and any expected ongoing annual subsidies from the government are incorporated in BCAs and, therefore, are considered intrinsic to an issuer's standalone financial strength.

BCAs are expressed on a lower-case alpha-numeric scale that corresponds to the alpha-numeric ratings of the global long-term rating scale.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0 - 30%), moderate (31 - 50%), strong (51 - 70%), high (71 - 90%) and very high (91 - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases GRIs demonstrate moderate to very high degrees of default dependence with their supporting governments, which reflects the existence of institutional linkages and shared exposure to economic conditions that draw credit profiles together.

Default dependence is described as either low (30%), moderate (50%), high (70%) and very high (90%).

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