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Does the Laurentian mess scupper the notion of implicit support? No

By Warren Lovely

Last week, one of Ontario's universities—Laurentian University (LU), up in Sudbury—took the rather exceptional step of filing for credit protection. You could sum up the reaction from many, be it students, faculty, credit rating agencies and interested observers (including more than a few bond investors), in one word: surprise. It was an unprecedented move, creating something of a black eye for a province (and a country) that pays almost constant lip service to the importance of education and training.

We may have gone to university in Ontario, but we wouldn't necessarily consider ourselves experts in how to run a post-secondary institution. Moreover, our normal-course credit analysis does not regularly extend to the university sector. We're not here to dwell excessively on the specific causes of the Laurentian mess, including the obligatory look in the rear-view policy mirror. We'll leave it to others (including subject matter experts and the media) to assign blame, a job some have attacked with relish.

Rather, we're here to ask a related question: if a 60-year old university with roughly 9,000 students subject to provincial oversight got to the financial brink and ultimately needed to seek creditor protection, what does it say about the broader concept of implicit government support? **Has the concept of extraordinary support been invalidated for other universities, public sector entities or sectors?** We ponder these and a few other questions...

How'd we get here? Much has already been written on LU's specific plight. At a high level, there appear to be a combination of idiosyncratic, cyclical and structural issues at play. LU's financial statements suggest it has been struggling for some time, running a deficit in four of the last five years.

As a general rule, Canadian universities don't have the most flexible financial model; their revenue streams are fairly narrow while much of their cost structure (including faculty salaries) is reasonably fixed. In a sector comment at the start of the academic year, Moody's noted that "universities face a range of credit challenges", not least of which was an uncertain/weak revenue outlook.

In Ontario's case, much has been made of an earlier 10% tuition cut mandated by the provincial government, followed by tuition freeze, which compounded financial stress across the system (and in some cases created a dependence on foreign students). LU may not be as heavily reliant on international students as others, but the pandemic has nonetheless disrupted the operating environment, making it difficult to mitigate pressures and in this case satisfy creditors. There are some who argue that Laurentian may have opted for a strategic restructuring, as part of a plan to revamp its educational offering.

What was Ontario's reaction? Ontario's government has a ministry—the [Ministry of Colleges and Universities](#)—tasked with overseeing higher education in Canada's most populous province and a minister, Ross Romano, who happens to be from the North. Laurentian states that it had "kept the Ministry of Colleges and Universities (MCU) fully apprised throughout the process leading to this step being taken". So if there was surprise at Queen's Park, there presumably shouldn't

have been. Officially, the government's initial reaction to the filing went something like this:

- **Remark:** "It is deeply concerning that Laurentian University has found itself in a situation where such drastic and immediate action is needed to ensure its long-term sustainability";
- **Action:** Ontario has appointed a special advisor to the minister to explore options to support Laurentian;
- **Reflection:** More broadly, and with a view to ensuring this situation isn't repeated, the government will explore its options, including potential legislation, "to ensure the province has greater oversight of university finances and to better protect the interest of students and Ontario taxpayers".

Who is Laurentian seeking protection from? We'd refer you to [official documents](#) accessible via the CCAA-appointed monitor (E&Y in this case). You'll find roughly C\$182 million in unsecured claims, with a Canadian bank occupying the top spot on the creditor list. Three Canadian banks are among Laurentian's 10 largest unsecured creditors.

Are there Laurentian bonds outstanding in the marketplace? No. Absent any public debt, Laurentian had not sought a credit rating from any of the major agencies. That's no small consideration. In other words, we're not talking about an investment grade-rated entity defaulting on a coupon or principal payment to various bond investors... something we feel would have much more gravity. We're nonetheless mindful of the fact that other universities (the clear majority located in Ontario) have publicly accessed Canada's debt capital markets. We've identified more than 20 rated Canadian universities, which have collectively issued 42 debentures totaling some C\$5.2 billion (par value). [Average issue size = C\$123 million; WATM = 27.8 years; WAC = 4.8%]

Indexers should know that, by our count, the FTSE Canada Universe Bond Index includes 26 securities issued by 17 unique Canadian universities, with current outstandings of C\$3.9 billion. In all cases, these uni bonds reside in the 'provincial' index, which speaks to the level of government where oversight ultimately rests.

Do rating agencies assume extraordinary provincial support at these other universities? Generally yes, although that doesn't necessarily bolster the assigned rating. Each of the 21 universities in our sample has at least one rating from S&P, Moody's or Morningstar DBRS.

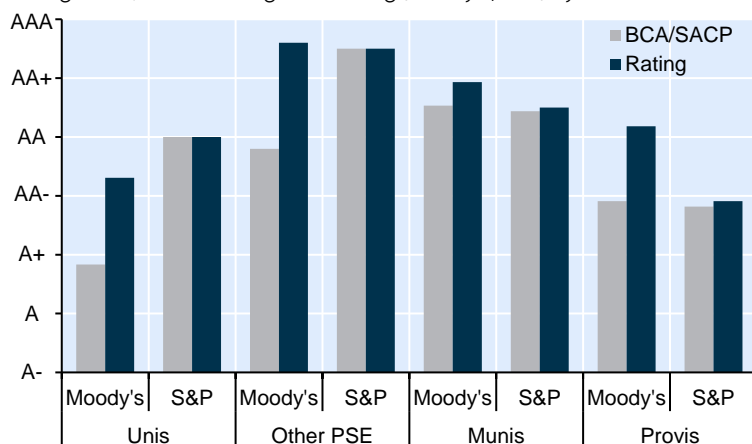
S&P rates the fewest number of universities (eight). The average rating is 'AA', and all are on "stable" outlook. In every case, the assigned rating is equivalent to the standalone credit profile (SACP). In other words, there's no rating uplift at S&P from what is nonetheless considered to be a "moderately high" to "high" likelihood of extraordinary provincial support. For S&P, this expectation generally reflects the priority provinces have tended to place on postsecondary education, the absence of private alternatives and/or replacement difficulty, provincial oversight and regulation, significance of provincial operating grants, provincial involvement in board selection, etc. Regarding Ontario's mandated tuition cut, S&P had earlier stated: "While the requirement to cut tuition fees was unexpected, it does not change our assessment of the government's likelihood of support".

Moody's rates 13 Canadian universities. The average rating leans towards Aa3, with one school on "negative" outlook (Windsor). Of the Ontario universities Moody's rates, Lakehead and Windsor each get one notch uplift to the baseline credit assessment (BCA) on a "high" likelihood of support. This is based on the "perceived risk to the province's reputation as a regulator of the university sector if [any university] were to default". The relatively newer UOIT benefits from two notches of uplift, where extraordinary support is considered "very high" (and where a college guarantee of an unsecured debenture further bolsters support for that particular entity). For non-Ontario universities, the perceived likelihood of provincial support generally means 1-2 notches of uplift (excepting UBC, which is at the upper end of the rating range and receives no uplift).

Morningstar DBRS rates 14 universities in our sample, with an average rating of A(high)–weaker on average, and subject to greater dispersion, than at S&P or Moody's. DBRS's Jan-2021 *Corporate Risk Assessment Scorecard* helps identify relative weak spots. Adequacy of government funding/tuition is an oft-noted risk factor, particularly for Ontario-based schools. Here and there, particularly for the lower-rated names, DBRS flags location/size/competition worries, weaker academic profiles, elevated debt or operating pressures.

Chart: How much implicit support built into ratings?

Average BCA/SACP vs. long-term rating (Moody's, S&P) by sector



Source: NBF, Moody's, S&P | Note: Simple average of long-term credit ratings, baseline credit assessment (BCA) & standalone credit profile (SACP); 'Unis' based on 21 Canadian universities in Ontario, Quebec, British Columbia & Saskatchewan; 'Other PSE' based on 6 public sector pension/asset managers; 'Munis' based on 20 largest rated issuers; 'Provis' based on 10 provinces plus BCMFA

Does the LU filing weaken this perceived support? Not necessarily. We're inclined to view the Laurentian situation as something of an isolated issue for an unrated university with no bonds outstanding. We'll leave it to credit rating agencies to formally comment on individual university ratings and the underlying methodology (including support). We can imagine more pointed questions being asked of university administrators in light of Laurentian's woes. To us, however, there's still a strong incentive for provincial governments to avoid university defaults, particularly for systemically important institutions and/or rated schools with public debt outstanding in the marketplace. Not to be too guided by history, but we've seen both Ontario (with UOIT) and Quebec (with UQAM) provide extraordinary support in the past. So we're not necessarily expecting rating agencies to radically rethink the nature of extraordinary support for universities (or other government related credits for that matter).

Beyond universities, is implicit support a thing? Absolutely. There are plenty of examples where issuers benefit from rating uplift due to an expectation of extraordinary government support. This is evident in the **infrastructure** and **utility** sectors, and is likewise observed with some **public sector entities** (including select provincial pension/asset managers).

There are a few cases, notably with respect to **hospitals** and **school boards**, where an entity's rating simply reflects the home province, given extremely close financial/institutional relationships and an almost certain likelihood of support. We're talking about the likes of Trillium Health Partners, The Hospital for Sick Children, 55 School Board Trust and Ontario Infrastructure and Lands Corp, where Moody's assigns Ontario's rating (i.e., there's no BCA). For some of these names, S&P likewise forgoes its traditional SACP.

A few large **municipal** credits benefit from implied support. Interestingly, none of these are in Ontario, where major munis generally boast stronger underlying credit profiles than the province itself. Montreal, Quebec City and TransLink each get a 1-2 notch ratings bump at Moody's, owing to a "high" likelihood of provincial support. FNFA, which is a somewhat unique public sector funding agency (PSFA), gets a single notch of uplift at both S&P and Moody's, given its strong link to the federal government and important public policy role.

Table: A sampling of rating uplift from implicit support

Examples of credit rating uplift vs. BCA (Moody's) or SACP (S&P)

Sector	Moody's	S&P
University	9 of 13 rated universities receive uplift vs. assigned BCA; ratings for 4 universities equivalent to assigned BCA Ont: LAKEHD(+1), UNVONT(+2), UNIW(+1) Que: CNCRDU(+2), MCGILL(+2), UQAMTL(+2) BC: SIMFRA(+2) Sask: UNIREG(+2), UOSASK(+1)	No universities (out of 8 rated entities) receive uplift vs. SACP
Utility/Infra	HYDONE(+1), ONTPOW(+3)	ONTPOW(+3), GTAIR(+1), NAVCAN(+1)
Other PSE	CPPIBC & PSPCAP receive no uplift vs. assigned BCA CADEPO(+2), ONTTFT(+2), OMERTF(+5)	None of CPPIBC, PSPCAP, CADEPO, ONTTFT, OPBFIN, OMERTF receive uplift vs. SACP
Municipal (based on 20 largest rated issuers)	No major Ontario cities or regional governments receive uplift vs. assigned BCA Que: MNTRL(+2), QC(+1) Transit: SOUCOA(+2) PSFA: FNFACA(+1)	No major cities or regional governments receive uplift vs. SACP PSFA: FNFACA(+1)
Provincial (incl. BCMFA)	9 provincial governments receive uplift vs. assigned BCA; BRCOL rating equivalent to assigned BCA ONT(+2), Q(+1), ALTA(+1), MP(+2), SCDA(+1), NS(+1), NBRNS(+2), NF(+2), PRINCE(+2)	No provincial governments receive uplift vs. SACP BCMFA(+1), reflecting unique taxing power

Source: NBF, Moody's, S&P, Bloomberg | Notes: This table is not meant to serve as an exhaustive list; included names represent examples of where the perceived likelihood of extraordinary government support leads to at least a single notch rating uplift vs. the assigned baseline credit assessment (BCA as per Moody's) or the standalone credit profile (SACP as per S&P); there may be other instances of implicit government support providing uplift; in some cases (e.g., certain hospitals, school boards) no BCA or SACP may be calculated, with ratings in some instances simply reflecting the home province; the one notch uplift for BCMFA vs. S&P's SACP is not due to implied government support but reflects extraordinary taxing power; figures inside brackets (:) denote number of notches of uplift; entities listed by Bloomberg ticker; based on long-term credit ratings, assigned BCAs and SACPs as at 9-Feb-2021

BCMFA technically receives one notch of additional support above its SACP at S&P. We would stress, however, that this uplift is *not* tied to implied government support but instead captures the truly unique and uber-powerful taxing authority that BCMFA enjoys (but has never needed to use) over BC's entire stock of real property. We continue to argue that BCMFA possesses one of the strongest credit frameworks in Canada's broader public sector, which could objectively warrant placement in the 'provincial' index as opposed to its current 'municipal' classification. BCMFA is far and away a stronger credit than the various universities that have been labeled 'provincial' for index purposes.

We could fill a whole separate note on the credit strengths and bondholder safeguards at the municipal level of government. In general, we see a considerably stronger argument for extraordinary provincial support than with universities. Quite simply, when it comes to implicit support, *munis trump unis*, all else being equal. After all, provincial governments tend to exert greater control and legislative influence at the municipal level, subjecting local/regional governments to tougher/more rigid financial performance requirements (including balanced operating budgets and borrowing restrictions). Moreover, we believe a default by a municipal government would cause a much greater political embarrassment than having an unrated university seek protection.

Finally, a word on **provinces**. When it comes to S&P, the ratings assigned to all ten provinces match the SACP (i.e., no ratings uplift from extraordinary support considerations). At Moody's, however, ratings uplift is a pretty consistent theme. Only for British Columbia does the rating match the BCA assigned at committee (they're both triple-A). Everywhere else Moody's gives a 1-2 rating notch boost, reflecting a "high" likelihood of support from the top-rated federal government in a distress situation. In provincials more than perhaps any other sub-sovereign segment, there's a strong reputational argument to be made. Moreover, there's the added issue of potential disruption to capital markets should a province face major difficulty. Consider: The 20 or so universities we've studied have just over C\$5 billion of bonds outstanding; the 20 largest municipal issuers have more than C\$45 billion outstanding; whereas Canada's 10 provinces have in excess of C\$900 billion of public debentures floating around, placed broadly with domestic and international investors alike.

As it happens, recent actions have allowed us to test the implicit support hypotheses. We've seen more than a few examples of the

federal government stepping up when needed. Consider the near-C\$20 billion *Safe Restart Agreement*, which funneled critical support to provinces and municipalities during the COVID-19 crisis. Just this week, Prime Minister Trudeau confirmed a permanent increase in federal funding for public transit (C\$3 billion/year starting in 2026-27), as part of a broader plan to build back better in the post-COVID world. There's the federal guarantee on Muskrat Falls and ongoing work on rate mitigation. It might not have been all the provinces asked for, but Ottawa has enriched fiscal stabilization payments (made to provinces suffering particularly painful year-on-year revenue declines). And who knows, we could soon see meaningful action from the feds on health transfers—priority one for Canada's premiers and a pretty obvious avenue to buttress provincial finances longer term.

Finally, don't forget the Bank of Canada's willingness to support provincial issuers during the pandemic, first with a money-market purchase facility and then via a provincial bond purchase program. (The latter program, the PBPP, is scheduled to end in May.) Thus, extraordinary support for Canada's provinces hasn't been limited to fiscal authorities.

In the final analysis, does the concept of implicit support survive the Laurentian filing? Yes. We suspect a genuine desire on the part of Ontario to avoid a repeat of the Laurentian scenario. For munis and provis, there clearly has been and likely will remain an ability and willingness to act when needed, given more pronounced risks (reputational and otherwise).

Saying that, the Laurentian filing reinforces the importance of due diligence. It generally pays to do your credit work, including a thorough examination of financial statements—which in LU's case might well have raised some flags a while back. This work is perhaps even more vital in today's pandemic-scarred landscape, where it's no longer 'business as usual' and where outlooks (for private corporations, public-sector enterprises, governments and yes, universities) have in many cases been jarred violently.

In many cases, investors can still put stock in the idea of extraordinary support, but keep a close eye on those standalone/baseline credit scores whenever and wherever an issuer benefits from a ratings uplift. After all, there are more than a few names in Canada where extraordinary support has been assumed... in the higher education sector for sure, but across the broader public sector universe.



Economics and Strategy

Montreal Office 514-879-2529

Stéfane Marion

Chief Economist and Strategist
stefane.marion@nbc.ca

Paul-André Pinsonnault

Senior Economist
paulandre.pinsonnault@nbc.ca

Daren King

Economist
daren.king@nbc.ca

Matthieu Arseneau

Deputy Chief Economist
matthieu.arseneau@nbc.ca

Angelo Katsoras

Geopolitical Analyst
angelo.katsoras@nbc.ca

Jocelyn Paquet

Economist
jocelyn.paquet@nbc.ca

Kyle Dahms

Economist
kyle.dahms@nbc.ca

Camille Baillargeon

Intern Economist
camille.baillargeon@nbc.ca

Toronto Office 416-869-8598

Warren Lovely

Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich

Rates Strategist
taylor.schleich@nbc.ca

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