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Moravian College, Pennsylvania; Private Coll/Univ - General Obligation

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Moravian College, Pennsylvania; Private Coll/Univ - General Obligation

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Long Term Rating	A-/Negative	Affirmed
Northampton Cnty Gen Purp Auth, Pennsylvania		
Moravian College, Pennsylvania		
ser 2012 and ser 2013		
Long Term Rating	A-/Negative	Affirmed

Rationale

Standard & Poor's Ratings Services revised its outlook to negative from stable on bonds issued for Moravian College, Pa. and affirmed its 'A-' long-term rating on Northampton County General Purpose Authority, Pa.'s series 2013 and series 2012 college general revenue bonds, issued for Moravian College. At the same time, Standard & Poor's affirmed its 'A-' issuer credit rating (ICR) on Moravian College.

The negative outlook reflects four years of enrollment declines, which have led to declining net tuition revenue and steadily declining operating results through fiscal 2013. Despite the enrollment and demand pressure, the adequate financial resource ratios compared with the rating category and lack of additional debt plans during the next two years support the current 'A-' rating. Management is taking steps to address its enrollment and operating challenges, which we believe could help to stabilize enrollment metrics and improve operating performance beyond fiscal 2014.

More specifically, the 'A-' rating reflects our opinion of Moravian's:

- Adequate financial resources for the rating category with expendable resources as of June 30, 2013, equal to approximately 120% of expenses and 138% of outstanding debt;
- Successful cost controls in fiscal 2013 that have limited the rate of decline in operating performance; and
- Balanced operations on a full accrual basis despite enrollment declines.

We believe somewhat offsetting credit factors include Moravian's:

- Limited demand profile, volatile applications, enrollment decreases during the past four years and weak retention;
- Significant regional competition with public and private liberal arts institutions;
- High maximum annual debt service (MADS) burden directly attributable to a $4.1 million balloon payment due in fiscal 2016;
- Net tuition revenue declines in the past two years and high dependence on student generated revenue accounting for 88% of fiscal 2013 revenue; and
- The college's outstanding debt (excluding the off-balance sheet debt) which is an unconditional general obligation of the obligated group, of which the college is the sole member, and is secured by a gross revenue pledge and a fully funded debt service reserve.

Founded in 1742 and now one of the oldest colleges in the nation, Moravian College and Theological Seminary is a private, coeducational college affiliated with the Moravian Church. Located in Bethlehem, Pa., the college serves about 1,750 students in three degree-granting divisions: the undergraduate college; the graduate theological seminary; and the center for continuing, professional, and graduate studies (the Comenius Center). Moravian offers nearly 50 undergraduate program options and pre-professional courses in dentistry, law, medicine, teacher education, theology, and veterinary medicine.

Outlook

The negative outlook reflects Standard & Poor's opinion of Moravian's declining enrollment and demand profile, as well as the deterioration in operating performance. We could consider a lower rating during the next one to two years if enrollment or financial resources decline further, or if operating performance deteriorates from current levels. Also, we could consider a lower rating if net tuition revenue declines further.

We could consider returning the outlook to stable during the two-year outlook period if the college maintains financial resources at current levels while stabilizing demand and enrollment and improving operating performance from current levels.

Enterprise Profile

Enrollment and demand

Moravian has limited demand flexibility and faces enrollment challenges due to high competition in the area. Exacerbating the enrollment pressure has been management turnover in the admissions department, with two new vice presidents for enrollment in two years. Full time equivalent (FTE) student enrollment decreased by almost 9% in the last two years to 1,555 in fall 2013 from 1,703 in fall 2011 due to decreases in headcount in traditional undergraduate courses. Traditional undergraduate enrollment, which represents roughly 90% of the student body, decreased by 4.1% in fall 2013 and 3.9% in fall 2012. Although management had projected FTE enrollment to stabilize in fall 2013, their freshman class came in lower at 357 compared with an expected headcount of 375. We understand that management is projecting flat enrollment for fall 2014, which should halt the recent downward trend.

Although demand metrics remain comparable with those of other 'A-' rated institutions in the Pennsylvania area, demand is showing signs of increased competitive pressure in the college's regional market that has led to weaker long-term enrollment, which is not surprising considering there are seven liberal arts colleges, including Moravian, and two community colleges in Lehigh Valley. The majority of Moravian's students come from the Pennsylvania, New York, and New Jersey markets.

Freshman applications have exhibited volatility over the past several years. After increasing by 17% in fall 2007, freshman applications decreased consecutively from fall semesters 2008-2011. Freshman applications increased by 5% to 2,034 in fall 2012 but again decreased by 20% to 1,636 in fall 2013. Matriculation rates were consistent with the rating at 27% for fall 2013. In our opinion, this indicates that Moravian experiences a fair degree of competition. Management attributes much of this trend to commonwealth-sponsored incentive programs that encourage community college attendance. In recent years, the college's selectivity has weakened to 80% in fall 2013 compared with the 64% fall 2007 rate. In turn, student quality indicators, while still well above average, also decreased over the same period. We believe that the college's freshman to sophomore retention rate is good at 78% in fall 2013, which recovered after a dip to 75% in fall 2012. Management attributes the improvement in retention to increased institutionally funded financial aid to address the needs of at-risk freshmen. The discount rates increased to 41% in fall 2013 from about 34% in fall 2007. In response to these demand challenges, Moravian has undertaken several initiatives to improve market position and address its long-term pricing strategy. With improved marketing and student outreach, Moravian increased applications in fall 2012. However, it could not maintain the momentum and fall 2013 applications decreased sharply. We understand management is working on a new strategic plan, under which the college is focusing on enhancing the students' experience by providing research opportunities to students in professional programs courses and internships to students enrolled in traditional liberal arts programs. In addition, they are working on tuition pricing and looking to reprioritize the courses and plan to add or discontinue some programs. Given Moravian's somewhat limited geographical reach, we believe the college will likely continue to struggle with student demand.

Management

Moravian is governed by a joint board of trustees that consists of 15 to 55 members nominated by the separate boards of the college and the seminary. The college president reports to both the college and seminary boards, and Moravian is supported by 11 key administrators. The college appointed its new Chairman of Board in April 2013. Moravian's President retired in July 2013 after seven years in the role. The college now has a new President, and indicates the leadership transition has been smooth. Most members of the President's Council have been with the college more than five years; two members, however, were appointed in 2012 to the finance and student affairs offices. In addition, the college appointed a new vice president of enrollment in November 2013 replacing the earlier vice president who joined in January 2012. Management indicated that a position for director of admission was vacant and expects to fill this position shortly. In our view, the frequent turnover in the enrollment department has prevented the enrollment and demand profile from stabilizing, and continues to limit opportunities for operating improvement in fiscal 2014. We expect the new vice president of enrollment and director of admissions to prevent further declines beyond fiscal 2014 as they acclimate to their respective roles. Management states that although it does not prepare full-accrual budgets, it builds significant contingencies into the budget that cover depreciation expenses in most years. We believe the administration provides rating stability due to management's proven ability to generate balanced operating performance on a full-accrual basis despite softening student demand. The college also maintains a formal investment policy and a long-term strategic plan, which we view as a best practice. We understand that the management is working on a new strategic plan that focuses on improving the students' experience at Moravian College.

Financial Profile

Operating performance

While Moravian's operations remain balanced on a full accrual basis, the margins have deteriorated in the recent years. Enrollment decreases and rising financial aid expenses have pressured operating performance recently. Fiscal 2013 operations were break even with, in our opinion, a small $84,000 full-accrual deficit. For fiscal 2013, the college reported a surplus of $3.6 million on cash basis. Management is projecting a small surplus on budgetary basis in fiscal 2014, but likely will produce breakeven full accrual results. Management indicated that in response to a decline in the enrollment, the college cut its fiscal 2014 budget by offering early retirement to some of its staff members. Management also noted that they do not anticipate any more budget cuts and expect balanced operations for the next few years.

In fiscals 2012 and 2013, Moravian's gross revenue has remained flat due to enrollment declines, while the increasing discount rate has produced negative net tuition revenue. The college's net tuition revenue decreased 2.5% in fiscal 2013 and 0.4% in fiscal 2012. Not unlike most small private liberal arts colleges, Moravian is highly dependent on student-related income with tuition, fees, and auxiliary operations accounting for 88% of fiscal 2013 revenue. We continue to monitor the college's discounting practices closely, particularly since institutionally sponsored aid continues to grow faster than tuition and fee revenue as Moravian increases financial awards to retain students. Moravian's freshman tuition discount was 56% in fall 2013 compared with 50% in fall 2012. In our opinion, the college's net tuition revenue will remain pressured in fiscal 2014 due to further increases in financial aid and decreasing enrollment.

Financial resources

In our opinion, Moravian's financial resource ratios remain adequate for the rating category. As of June 30, 2013, cash and investments were equal to $109 million, or 150% of operating expenses and 172% of outstanding debt, including off-balance-sheet housing financing. Fiscal 2013 expendable resources, a more conservative measure than cash and investments, at $87 million were equal to 120% of operating expenses and 138% of outstanding debt compared with medians of 85% and 141%, respectively, for the 'A' category.

Debt and contingent liabilities

As of June 30, 2013, Moravian's total debt outstanding was $63.2 million when including off-balance-sheet financing of approximately $24.3 million issued by Moravian College Housing, Inc. (MCHI). This also includes an additional $4.5 million bank qualified bond issued in fiscal 2011 for the renovation of Moravian's recreation center and various other facility improvements. Although we do not rate the bank qualified bond debt, we consider it a contingent liability and have reviewed the bank qualified loan document and determined it does not pose additional event-driven risk. The failure to perform certain covenants would be an event of default and would cause acceleration of the bonds, mitigated by a 30-day cure period. We regard this as additional bank exposure risk, but we believe Moravian has sufficient assets to cover any acceleration of the $4.5 million debt. Management reports that as of Aug. 31, 2013, the college had approximately $55 million of investments available for daily liquidity, which we believe provide sufficient cushion. While the college plans to retire or refinance bank qualified bond debt, the $4.1 million 2016 balloon payment associated with this financing pushes the MADS burden to, what we consider, a high 8.9% of fiscal 2013 expenses. Without this payment, debt service is a manageable 4% of the annual budget.

Moravian leases a portion of the nonresidential space completed as part of the MCHI financing. It is a 30-year lease in which Moravian pays MCHI $1.5 million during the first 10 years of the arrangement. It has also invested approximately $2 million for equipment, parking, and landscaping on the Hurd Campus, the site of the residence hall. In addition, the college has provided a $1 million subordinated loan to MCHI. As part of its agreement with MCHI, the college created a budget to support building operations. The college is responsible for providing maintenance services, for which it will be reimbursed; invoicing students; and integrating this housing with the existing on-campus housing. Students, however, sign lease agreements directly with MCHI.

The obligated group, of which the college is the sole member, further pledges to maintain annual net revenue available for debt service at levels sufficient to cover the annual debt service requirement by at least 1x. Bondholders are also provided an additional bonds test that we consider weak due to the discretionary latitude it provides the issuer in choosing either a prospective or retrospective assessment of one of six measures of debt service, total indebtedness, net assets, or net revenue.

Although the college has additional capital needs, it does not plan to issue new debt during the next two years. It plans to fund these capital projects with proceeds from fundraising.

Endowment and fundraising

Moravian maintains a small endowment, valued at $90.5 million as of June 30, 2013. Although the endowment has notable exposure to private equity, 65% of all investments are classified as level 1 and level 2 marketable securities in the fiscal 2013 audited financial statements, confirming management's report (as of Aug. 31, 2013) that 64%, or $55 million, of its investments have daily liquidity. As of Aug. 31, 2013, approximately 39.9% of investments were allocated to equity investments, 27.2% to alternatives, 13.7% to fixed income, 13.9% to real estate assets, and 5.3% to cash. Moravian College had about $9.6 million in uncalled capital commitments as of Aug. 31, 2013, which was manageable, in our opinion, at 11% of invested assets as management stated that the college temporarily holds the required funds in liquid mutual funds. The endowment spending target is typical and remains 4.5% of a three-year moving average. However, we understand that the management has budgeted to increase its endowment spending rate to 5% in fiscal 2014 for budgetary relief, but they plan to scale back the endowment spending rate to 4.5% in fiscal 2015.

Moravian does not have a strong fundraising history, but it has renewed its commitment to building this revenue source and improving its balance sheet. The college is in the public phase of a $45 million campaign that began in fall 2008, and Moravian expects this campaign to conclude in June 2015. The college intends to use campaign proceeds to enhance the science facilities; support renovations to the Hurd Campus dormitories; and provide funding for faculty development, financial aid, and operations. To date, Moravian has raised $38 million toward its goal, $35 million of which it has collected.

Moravian College, Pa., Financial And Enrollment Statistics

	--Fiscal year ended June 30--				Medians for 'A' rated private colleges and universities	Medians for 'BBB' rated private colleges and universities
	2013	2012	2011	2010	2012	2012
Enrollment and Demand						
Headcount (HC)	1,802	1,899	1,926	2,069	MNR	MNR
Full time equivalent (FTE)	1,618	1,703	1,726	1,746	3,445	3,195
Freshman acceptance rate (%)	78.5	79.7	75.9	75.3	64.0	71.0
Freshman matriculation rate (%)	23.7	24.3	25.0	25.0	24.0	25.0

Moravian College, Pa., Financial And Enrollment Statistics (cont.)						
Undergraduates as a % of total enrollment (%)	91.9	87.3	91.4	86.8	79.0	77.0
Freshman retention (%)	75.5	78.0	78.0	78.3	86.4	78.0
Graduation rates (5 years) (%)	76.0	74.0	74.0	74.3	74.0	58.8
Income Statement						
Adjusted operating revenue ($000s)	72,560	73,690	71,972	71,888	MNR	MNR
Adjusted operating expense ($000s)	72,644	73,512	70,563	70,224	MNR	MNR
Net operating income ($000s)	(84)	178	1,409	1,664	MNR	MNR
Net operating margin (%)	-0.1	0.2	2.0	2.4	2.1	1.8
Change in unrestricted net assets ($000s)	1,088	(982)	3,581	2,480	MNR	MNR
Tuition discount (%)	41.4	40.2	39.0	38.0	34.0	31.2
Tuition dependence (%)	72.5	71.8	72.3	71.2	70.2	76.9
Debt						
Outstanding debt ($000s)	63,210	55,095	51,932	50,132	95,019	53,292
Current debt service burden (%)	3.58	2.91	3.57	4.35	3.98	3.80
Current MADS burden (%)	8.90	8.34	8.69	4.51	MNR	MNR
Financial Resource Ratios						
Endowment market value ($000s)	90,484	84,146	84,071	67,205	182,270	50,532
Cash and investments ($000s)	108,768	102,059	107,001	84,743	MNR	MNR
Unrestricted net assets ($000s)	76,221	75,133	76,115	72,534	MNR	MNR
Expendable resources ($000s)	87,287	78,648	84,084	71,644	MNR	MNR
Cash and investments to operations (%)	149.7	138.8	151.6	120.7	130.2	66.1
Cash and investments to debt (%)	172.1	185.2	206.0	169.0	228.3	121.8
Expendable resources to operations (%)	120.2	107.0	119.2	102.0	84.9	36.9
Expendable resources to debt (%)	138.1	142.7	161.9	142.9	141.4	71.4
Average age of plant (years)	18.5	17.6	16.7	16.0	12.5	12.1

Footnotes

N.A.--Not available. MNR--median not reported. Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100 times (net adjusted operating income/adjusted operating expense). Tuition dependence = 100 times (gross tuition revenue/adjusted operating revenue). Current debt service burden = 100 times (current debt service expense/adjusted operating expenses). Current MADS burden = 100 times (maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short-term and long-term investments.

Related Criteria And Research

Related Criteria

USPF Criteria: Higher Education, June 19, 2007