# Research

# 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 has affirmed its 'A-' 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 outlook is negative.

The ratings reflect our view of four years of enrollment declines, which have led to declining net tuition revenue and steadily declining operating results through fiscal 2014. The college's high reliance on student-generated revenues is also a limiting credit factor. In our opinion, Moravian's adequate financial resource ratios and improved demand for fall 2014 support the 'A-' rating. Also, we believe the college will need to maintain stable enrollment and demand metrics, given its high reliance on student generated charges. Moravian plans to issue additional debt over the next two years, primarily for various capital improvement purposes. Although we believe that the balance sheet has limited flexibility to absorb additional debt, we have not incorporated it in our analysis given the uncertainty regarding the amount.

The 'A-' rating reflects our assessment of Moravian's:

- Balanced full-accrual operations despite enrollment declines; and
- Adequate financial resources for the rating, with expendable resources as of June 30, 2014, equaling approximately 117% of expenses and 138% of debt.

We believe somewhat offsetting credit factors include Moravian's:

- Decline in enrollment in each of the past four years, which a good increase in fall 2014 partially mitigates;
- 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 three years and high dependence on student-generated revenue, which accounted for 89% of fiscal 2014 revenue; and
- Debt outstanding (excluding the off-balance sheet debt). It 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 1,850 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 recent year 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. Also, we could consider a lower rating if net tuition revenue declines further.

We could consider an outlook revision to stable during the two-year outlook period if the college maintains financial resources while stabilizing demand and enrollment and improving operating performance. We do not believe a positive rating action is likely within the outlook period, given Moravian's debt issuance plans, which will likely stress the college's financial resource ratios.

## Enterprise Profile

### Enrollment and demand

Moravian has limited demand flexibility and faces enrollment challenges due to high competition in the area. Full-time equivalent (FTE) student enrollment decreased almost 9% to 1,555 in fall 2013 from 1,703 in fall 2011, due to lower numbers in traditional undergraduate courses. However, FTE enrollment increased by 7.4% in fall 2014 to 1,670 on account of increased marketing efforts. Traditional undergraduate enrollment, which represents about 88% of the student body, increased 4.4% in fall 2014, compared to a decline of 4.1% in fall 2013 and 3.9% in fall 2012. We understand that management is projecting further enrollment increase for fall 2015, which in our opinion is positive, given the college's high dependency on student generated revenues.

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 Moravian's regional market that has led to weaker long-term enrollment, which is not surprising considering there are seven liberal arts colleges 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 levels have been volatile in the past several years. Applications increased 5% to 2,034 in fall 2012, but decreased 20% to 1,636 in fall 2013 6.2% to 1,535 in fall 2014. Matriculation rate was at 29% for fall 2014. In our opinion, this indicates that the college experiences a fair degree of competition. Management attributes much of this trend to commonwealth-sponsored incentive programs that encourage community college attendance. Moravian's selectivity weakened to 86% in fall 2014 compared with 80% in fall 2013 and 70% in fall 2008. In turn, student quality indicators, while still well above average, also decreased in that period. We believe that the college's freshman-to-sophomore retention rate is good, at 79% in fall 2014, which recovered after a dip to 75% in fall 2012. Management attributes the improvement to increased institutionally funded financial aid to address the needs of at-risk freshmen. The discount rates increased to 43% in fall 2013 from about 35% in fall 2008. 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, looking to reprioritize the courses, and plan to add or discontinue some programs.

### Management

Governing Moravian is a joint board of trustees that consists of 15-55 members. The college president reports to both the college and seminary boards, and 11 key administrators support Moravian. In 2014, management appointed a new director for admission. Management indicated that the academic dean will retire in June 2015. The college is completing the search process and expects to fill this position by July 2015. It also 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 full-accrual operating performance 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 management is working on a new strategic plan that focuses on improving the students' experience.

## Financial Profile

### Operating performance

While Moravian's full-accrual operations remain balanced, the margins have deteriorated in recent years. Enrollment decreases and rising financial aid expenses have pressured operating performance recently. Fiscal 2014 operations were breakeven with what we view as a small $404,000 full-accrual deficit. For fiscal 2014, the college reported a surplus of $4.0 million on cash basis. Management is projecting a small full-accrual surplus in fiscal 2015, mainly on account of improved enrollment for fall 2014.

In fiscal years 2013 and 2014, Moravian's gross revenue has remained flat due to enrollment declines, while the increasing discount rate has produced a decline in net tuition revenue. The college's net tuition revenue decreased 3.0% in fiscal 2014 and 2.5% in fiscal 2013. Not unlike most small private liberal arts colleges, Moravian depends highly on student-related income with tuition, fees, and auxiliary operations accounting for 89% of fiscal 2014 revenue. We continue to monitor the college's discounting practices closely, particularly because institutionally sponsored aid continues to grow faster than tuition and fee revenue as Moravian increases financial awards to retain students. The college's freshman tuition discount was 52.6% in fall 2013, compared with 50% in fall 2012. For fall 2014, the freshman discount rate fell to 50.3%. Management plans to reduce the rate to 47% in the next three years.

### Financial resources

In our opinion, Moravian's financial resource ratios remain adequate for the rating category. As of June 30, 2014, cash and investments equaled $115 million, or 160% of operating expenses and 189% of debt, including off-balance-sheet housing financing. Fiscal 2014 expendable resources, a more conservative measure than cash and investments, at $84 million, equaled 117% of operating expenses and 138% of debt compared with medians for the 'A' category of 90% and 152%, respectively.

### Debt and contingent liabilities

As of June 30, 2014, Moravian's total debt was $61.0 million including off-balance-sheet financing of approximately $24.3 million issued by Moravian College Housing Inc. (MCHI). This also includes an additional $4.2 million bank qualified bond issued in fiscal 2011 for the construction 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. We have reviewed the 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, which a 30-day cure period would mitigate. We regard this as additional bank exposure risk, but we believe Moravian has sufficient assets to cover any acceleration of the $4.2 million debt. Management reports that as of July 31, 2014, the college had approximately $60 million of investments available for daily liquidity, which we believe provide sufficient cushion. Although Moravian plans to refinance the 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 2014 expenses. Without this payment, debt service is 4% of the annual budget, which we believe is manageable.

Moravian leases a portion of the nonresidential space completed as part of the MCHI financing. Under the 30-year lease, which Moravian pays MCHI $1.5 million during the first 10 years. 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, Moravian 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. We understand that the college has capital needs and it plans to issue related debt in the next two years . Although we believe that the balance sheet has limited flexibility to absorb additional debt, we have not incorporated the plans into our analysis.

### Endowment and fundraising

Moravian maintains what we consider a small endowment, valued at $101.3 million as of June 30, 2014. Although the endowment has 12% exposure to private equity, 67% of all investments are classified as level 1 and level 2 marketable securities in the fiscal 2014 audited financial statements. As of June 30, 2014, approximately 37.8% of investments were allocated to equity investments, 33.8% to alternatives, 13.8% to fixed income, 13.1% to real estate assets, and 1.6% to cash. Moravian had about $12.0 million in uncalled capital commitments as of June 30, 2014, which was manageable, in our opinion, given the college has approximately $60 million of investments available for daily liquidity. The endowment spending target is typical and remains 4.5% of a three-year moving average. However, we understand that management increased its endowment spending rate to 5% in fiscal 2014 for budgetary relief, but it has scaled 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 October 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 $41 million toward its goal.

## Moravian College -- Financial Statistics

| | --Fiscal year ended June 30-- | | | | | |
|---|---|---|---|---|---|---|
| | **2015** | **2014** | **2013** | **2012** | **2011** | **Medians for 'A' private colleges universities, 2013** |
| **Enrollment and demand** | | | | | | |
| Headcount | 1,869 | 1,749 | 1,802 | 1,899 | 1,926 | MNR |
| Full-time equivalent | 1,670 | 1,555 | 1,618 | 1,703 | 1,726 | 3,442 |
| Freshman acceptance rate (%) | 86.3 | 80.0 | 78.5 | 79.7 | 75.9 | 64.0 |
| Freshman matriculation rate (%) | 29.2 | 27.3 | 23.7 | 24.3 | 25.0 | 22.2 |
| Undergraduates as a % of total enrollment (%) | 87.9 | 90.6 | 91.9 | 87.3 | 91.4 | 77.7 |
| Freshman retention (%) | 79.0 | 78.0 | 75.5 | 78.0 | 78.0 | 86.5 |
| Graduation rates (five years) (%) | 74.0 | 74.0 | 76.0 | 74.0 | 74.0 | 74.8 |
| **Income statement** | | | | | | |
| Adjusted operating revenue ($000s) | N.A. | 71,686 | 72,560 | 73,690 | 71,972 | MNR |
| Adjusted operating expense ($000s) | N.A. | 72,090 | 72,644 | 73,512 | 70,563 | MNR |
| Net operating income ($000s) | N.A. | (404) | (84) | 178 | 1,409 | MNR |
| Net operating margin (%) | N.A. | -0.56 | -0.12 | 0.24 | 2.00 | 1.60 |
| Change in unrestricted net assets ($000s) | N.A. | 1,773 | 1,088 | (982) | 3,581 | MNR |
| Tuition discount (%) | N.A. | 43.3 | 41.4 | 40.2 | 39.0 | 34.2 |
| Tuition dependence (%) | N.A. | 73.7 | 72.5 | 71.8 | 72.3 | 70.5 |
| Student dependence (%) | N.A. | 88.8 | 87.8 | 88.6 | 89.1 | MNR |
| Healthcare operations dependence (%) | N.A. | N.A. | N.A. | N.A. | N.A. | MNR |
| Research dependence (%) | N.A. | 1.3 | 1.2 | 1.2 | 1.1 | MNR |
| Endowment and investment income dependence (%) | N.A. | 8.1 | 7.1 | 6.9 | 5.3 | MNR |
| **Debt** | | | | | | |
| Debt outstanding ($000s) | N.A. | 61,049 | 63,210 | 55,095 | 51,932 | 89,201 |
| Proposed debt ($000s) | N.A. | 0 | N.A. | N.A. | N.A. | MNR |
| Total pro forma debt ($000s) | N.A. | 61,049 | N.A. | N.A. | N.A. | MNR |
| Current debt service burden (%) | N.A. | 4.03 | 3.58 | 2.91 | 3.57 | 3.93 |
| Current MADS burden (%) | N.A. | 8.99 | 8.90 | 8.34 | 8.69 | MNR |
| Pro forma MADS burden (%) | N.A. | N.A. | N.A. | N.A. | N.A. | MNR |

| Moravian College -- Financial Statistics (cont.) | | | | | | |
|---|---|---|---|---|---|---|
| **Financial resource ratios** | | | | | | |
| Endowment market value ($000s) | N.A. | 101,278 | 90,484 | 84,146 | 84,071 | 197,497 |
| Cash and investments ($000s) | N.A. | 115,278 | 108,768 | 102,059 | 107,001 | MNR |
| Unrestricted net assets ($000s) | N.A. | 77,994 | 76,221 | 75,133 | 76,115 | MNR |
| Expendable resources ($000s) | N.A. | 84,430 | 87,287 | 78,648 | 84,084 | MNR |
| Cash and investments to operations (%) | N.A. | 159.9 | 149.7 | 138.8 | 151.6 | 139.3 |
| Cash and investments to debt (%) | N.A. | 188.8 | 172.1 | 185.2 | 206.0 | 243.8 |
| Cash and investments to pro forma debt (%) | N.A. | 188.8 | N.A. | N.A. | N.A. | MNR |
| Expendable resources to operations (%) | N.A. | 117.1 | 120.2 | 107.0 | 119.2 | 90.3 |
| Expendable resources to debt (%) | N.A. | 138.3 | 138.1 | 142.7 | 161.9 | 151.5 |
| Expendable resources to pro forma debt (%) | N.A. | 138.3 | N.A. | N.A. | N.A. | MNR |
| Average age of plant (years) | N.A. | 16.6 | 18.5 | 17.6 | 16.7 | 12.5 |

MADS--Maximum annual debt service. MNR--Median not reported. N.A.--Not available.

# Related Criteria And Research

## Related Criteria

- USPF Criteria: Higher Education, June 19, 2007
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012

## Related Research

- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014