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Northampton County General Purpose Authority, Pennsylvania Moravian College; Private Coll/Univ - General Obligation

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Table Of Contents

Northampton County General Purpose Authority, Pennsylvania
Moravian College; Private Coll/Univ - General Obligation

Credit Profile		
US$21.805 mil rfdg bnds (Moravian College) ser 2012 due 07/01/2031		
Long Term Rating	A-/Stable	New
Moravian College ICR		
Long Term Rating	A-/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services assigned its 'A-' long-term rating to the Northampton County General Purpose Authority, Pa.'s series 2012 college revenue bonds issued on behalf of Moravian College (MC or Moravian), located in Bethlehem, Pa. Standard & Poor's also affirmed its 'A-' issuer credit rating on the college. The outlook is stable.

The 'A-' rating reflects Moravian's historically positive operating performance and solid financial resource ratios despite recent declines in enrollment. These factors are somewhat tempered by a high pro forma maximum annual debt service (MADS) burden that is directly attributable to a $4.1 million balloon payment due in fiscal 2016. Since 89% of the college's revenue is derived from student-related charges, weakening student demand trends and rising tuition discounting are reflected in the rating as well. While Moravian is taking steps to address its competitive challenges, the increased operating pressure and potential weakening of the balance sheet resulting from weaker student demand, declining enrollment, and lower retention will likely constrain the rating at this level for the foreseeable future.

More specifically, the 'A-' rating reflects our view of MC's:

- Consistently balanced or positive operating results on a full accrual basis with operating margins ranging from negative 0.3% to 17.5% since at least fiscal 2006 -- levels sufficient to cover annual debt service 1.8x to 5.1x;
- Solid financial resources for the rating category with expendable resources as of June 30, 2011, equal to approximately 121% expenses and 160% of outstanding debt; and
- Management's proven ability to generate positive operating performance despite enrollment fluctuations.

Offsetting credit factors, in our view, include:

- Recent enrollment declines and a weakening student demand profile marked by lower applications in six of the past seven years, reduced selectivity, lower matriculation rates, and moderating retention;
- Significant regional competition from both public and private liberal arts institutions;
- Limited revenue diversity, with student-related charges representing 89% of fiscal 2011 revenues; and
- High pro forma maximum annual debt service burden of approximately 8.3% of fiscal 2011 operating expenses.

Proceeds from the series 2012 revenue bonds, approximately $21.8 million in fixed-rate, serial debt, will be used to refund Moravian's outstanding series 1999 and series 2001 revenue bonds. The bonds, as well as $31 million in parity debt outstanding, are unconditional general obligations of the obligated group, of which the college is the sole member, and are secured by a gross revenue pledge and a fully funded debt service reserve (DSR). The funds in the DSR may be replaced with an irrevocable letter of credit or surety policy subject to certain rating restrictions on the credit facility's provider. The obligated group further pledges to maintain annual net revenues available for debt service at levels sufficient to cover the annual debt service requirement by at least 1.0x. Bondholders are also provided an additional bonds test that Standard & Poor's considers weak given 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. Post issuance, MC's total debt outstanding will rest at approximately $53 million based on fiscal 2011 audited financial statements. This includes $22 million in off-balance-sheet debt issued by Moravian College Housing, Inc. (MCHI), for the purposes of constructing a mixed-use facility that included a 231-bed residence hall on the college's Hurd Campus.

Founded in 1742 and now one of the oldest colleges in the country, Moravian College and Theological Seminary is a private, coeducational, college affiliated with the Moravian Church. Located in Bethlehem, Pa., the school serves more than 2,000 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). MC offers nearly 50 undergraduate program options as well as pre-professional courses in dentistry, law, medicine, teacher education, theology, and veterinary medicine.

Outlook

The stable outlook reflects our view that during the next 18 to 24 months, the college will likely maintain expendable financial resources relative to debt at current, or higher, levels; net operating revenue will likely remain positive on a full-accrual basis; and enrollment will likely stabilize while the college attempts to enhance demand.

If student demand and enrollment metrics weaken and drive operating performance into negative territory on a Generally Accepted Accounting Principle basis, or if balance sheet measures weaken to levels below those of the rating category, we may consider negative rating actions. On the other hand, if the college were able to build expendable resources considerably while maintaining a modest debt burden and sustaining its current operating and enrollment performance, positive rating actions would be possible. Endowment growth would also be viewed favorably due to the potential effect on college operations through the spending policy and the potential increase in unrestricted resources.

Enterprise Profile

Demand

Total enrollment at MC has been relatively flat to declining since at least fall 2004, with the total number of FTE students fluctuating between 1,704 and 1,755 during the seven-year period ending with fall 2011. Traditional undergraduate enrollment, which represents roughly 91% of the student body, has grown only modestly over time, in our view, rising to 1,603 for fall 2011 from 1,584 FTE in fall 2004.

Although demand metrics remain comparable to those of other 'A-' institutions in the Pennsylvania area, demand is showing signs of increased competitive pressure in the college's regional market and has lead 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 and no more than 20% of Moravian's students come from outside the Pennsylvania, New York, and New Jersey markets. Going into fall 2011, freshman applications continued to deteriorate, marking the fourth consecutive year of declines and the sixth drop in the past seven years. Matriculation rates have followed suit and, in our opinion, indicates MC is not the school of choice for many applicants. Management attributes much of this trend to state-sponsored incentive programs encouraging community college attendance. In order to facilitate improved new student enrollment, the college responded by reducing its selectivity and, thus, pushed acceptance rates to nearly 80% in fall 2011, a 10% increase over that of fall 2008. In turn, student quality indicators, while still well above average, also declined. The academic unpreparedness of these students consequently served, together with rising prices, to depress retention rates in recent years. Moravian indicates it is concerned about this issue and, to manage it, has implemented several organized approaches to addressing the needs of "at-risk" freshmen. However, the bulk of students leaving the college cited financial reasons, which are at the core of falling retention rates. In response, MC has awarded additional institutionally funded financial aid to support retention. Although the college's discount rate is still lower than that of many of its peers, like management, we believe consistently higher discounting is unsustainable over the long-term.

In response to these demand challenges, the college has undertaken several initiatives to improve its market position and address its long-term pricing strategy. Administrative officials have indicated improved marketing and student outreach have been effective and report that fall 2012 applications and acceptances are well ahead of those at the same time the prior year, suggesting the college will likely meet its freshmen enrollment target for the coming year if matriculation rates hold. Given MC's somewhat limited geographical reach, however, we believe the college will continue to struggle with student demand unless it can successfully expand its recruiting efforts beyond its immediate region and implement a pricing strategy that improves the strategic allocation of its financial aid resources.

Management

The college is governed by a joint board of trustees, which 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 is supported by 11 key administrators. Most members of the president's cabinet have been with the college more than five years, with the shortest tenures in the advancement and enrollment offices. Management states that although it does not prepare full accrual budgets, it does build significant contingencies into the budget that cover depreciation expense in most years. We believe administration provides stability to the rating given management's proven ability to generate positive 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.

Financial Profile

Operations: financial performance

MC's operating performance has been positive or balanced since at least fiscal 2006 with operating margins that have varied widely from 0.3% to a high of 17.5%. Large gifts in fiscals 2007 and 2008 pushed operating margins to historical highs of 11.2% and 17.5%, respectively. Even without these gifts, however, operations would still have been sufficient to cover maximum annual debt service more than 2.5x, While operations in fiscals 2009, 2010, and 2011 moderated as a result of enrollment pressure, excluding gift revenue, surpluses were still similar to those of prior years covering MADS more than 1.1x.

Not unlike most small, private, liberal arts colleges, MC is highly dependent on student-related income, with tuition, fees, and auxiliary operations accounting for more than 89% of fiscal 2011 revenue. For that reason, we will monitor the college's discounting practices closely, particularly since institutionally sponsored aid grew faster than tuition and fee revenue in fiscal 2010 as MC increased financial aid awards in an effort to retain students. While the financial aid budget continued to grow in fiscal 2011, tuition rate increases offset the growth in this expense to hold net tuition revenue steady relative to that of the prior year. Together with conservative budgeting practices and careful cost containment efforts, operations remained positive on a full accrual basis nevertheless. Private gifts and grants represent another 2.8% of MC's total unrestricted revenue, investment income totals another 2.3%, and government grants and contracts at 1.1% of total revenue, rounding out MC's three largest revenue sources following student-related charges.

Balance sheet: financial resources

Since suffering substantial investment losses in fiscal 2009, net assets have since improved as a result of positive investment returns and increased gift revenue--nearly recovering from the market volatility experienced globally during that year. As of June 30, 2011, cash and investments were equal to $107 million, or 152% of operating expenses and 201% of debt outstanding (including an off-balance-sheet housing financing). Fiscal 2011 expendable resources -- a more limited measure than cash and investments -- were equal to 121% of operating expenses and 160% of outstanding debt, compared with medians of 81% and 126% respectively, for the 'A' category.

Post issuance, Moravian's total debt outstanding will reach approximately $53 million when including an off-balance-sheet financing of approximately $22 million, issued by Moravian College Housing, Inc. (MCHI) for the purposes of constructing a mixed use facility that included a 231-bed residence hall space on the college's campus. All remaining debt, about $31 million, is a fixed-rate obligation of the college on parity with the series 2012 refunding. This includes an additional $5 million bank qualified bond issuance completed during fiscal 2011 for the renovation of MC's recreation center and various other facility improvements. While the college plans to retire or refinance this debt, the balloon payment in 2016 associated with this financing pushes the pro forma MADS burden to a level of expenses we consider high: 8.3%. Without this payment, debt service is manageable in our view, at 3.6% of the annual budget.

The college leases a portion of the non-residential space completed as part of the MCHI. It is a 30-year lease in which MC pays MCHI $1.5 million during the first 10 years of the arrangement. As part of its agreement with Moravian College Housing Inc., the college created a fund to support building operations and has also invested approximately $2 million in parking and landscaping on the Hurd Campus, the site of the residence hall, as well as another $2.5 million for furnishings and equipment. Pursuant to the operating agreement, the college is responsible for providing maintenance and custodial services for which it will be reimbursed; invoicing students; and integrating this housing with the existing housing on campus. Students sign lease agreements directly with Moravian College Housing, however.

MC is carrying nearly $21 million in deferred maintenance and has capital plans for which it may complete additional borrowings of approximately $10 million during the next five years.

MC maintains a small endowment valued at $84 million as of June 30, 2011, compared with its high of $94 million at the end of fiscal 2007 -- an overall decline of approximately 10.6% as the result of recent market turmoil. Although the endowment has notable exposure to private equity, nearly 60% of the value of all investments are in level 1 and level 2 marketable securities. As of Sept. 30, 2011, approximately 39% of investments were allocated to equity investments, 31% to fixed-income, 17% to hedge funds, 21% to real assets and private equity, and 2% to cash. The endowment spending target is typical and remains 4.5% of a three-year moving average.

MC does not have a strong fundraising history but has renewed its commitment to building this revenue source and improving its balance sheet. The school recently entered the public phase of a $45 million campaign that began in fall 2008 and is expected to run six to seven years. We understand that campaign proceeds will be used to enhance science facilities, to support renovations to the Hurd dorms, and to provide funding for faculty development, financial aid, and operations. To date, the college has raised $31.5 million toward its goal -- $27.2 million of which has been collected.

Moravian College

Financial and Demand Statistics

	Year-to-date	--Fiscal Year Ended June 30--			
	2012	**2011**	**2010**	**2009**	**2008**
Enrollment and demand					
Headcount (HC)	1,899	1,926	2,069	2,054	2,022
Full time equivalent (FTE)	1703	1,726	1,746	1,748	1,755
Freshman selectivity (%)	79.7	75.9	75.3	69.7	64.0
Freshman matriculation (%)	24.3	25.0	25.0	26.5	26.8
Undergraduate HC to total HC (%)	87.3	91.4	86.8	88.5	88.3
Income statement					
Adjusted operating revenue ($000s)	N.A.	71,972	71,888	71,134	75,384
Adjusted operating expense ($000s)	N.A.	70,563	70,224	69,154	64,135
Operating income ($000s)	N.A.	1,409	1,664	1,980	11,249
Operating margin (%)	N.A.	2.0	2.4	2.9	17.5
Change, UNA ($000s)	N.A.	3,581	2,480	1,926	9,136
Bottom line change, UNA (%)	N.A.	5.1	3.5	2.8	14.2
Institution tuition discount (%)	N.A.	39.0	38.0	34.7	33.8
Debt					
Outstanding debt ($000s)	N.A.	53,307	50,132	51,050	52,747
Pro forma debt ($000s)	N.A.	52,642	50,132	51,050	52,747
Net available for debt service ($000s)‡	N.A.	6,479	6,729	6,995	16,039
Pro forma MADS ($000s)	N.A.	5,854	N.A.	N.A.	N.A.
Pro forma MADS coverage (x)	N.A.	1.1	N.A.	N.A.	N.A.
MADS as % of expenses (%)	N.A.	8.3	N.A.	N.A.	N.A.
Liquidity ratios					
Endowment market value ($000s)	N.A.	84,071	67,205	63,032	81,853
Cash and investments ($000s)	N.A.	107,001	84,743	81,609	96,510
Unrestricted resources (UR)* ($000s)	N.A.	57,614	51,222	49,789	48,837
Expendable resources (ER)§ ($000s)	N.A.	85,459	71,644	68,071	82,000
UR to pro forma debt (%)	N.A.	109.4	102.2	97.5	92.6
UR to expenses (%)	N.A.	81.6	72.9	72.0	76.1
ER to proforma debt (%)	N.A.	162.3	142.9	133.3	155.5

Moravian College (cont.)					
ER to expenses (%)	N.A.	121.1	102.0	98.4	127.9
Net fixed assets ($000s)	N.A.	71,808	71,444	71,315	72,038
Average age of plant (years)†	N.A.	16.7	16.0	15.6	14.9

MADS--Maximum annual debt service. N.A.--Not available. *UR equals unrestricted net assets minus (net plant and equipment minus outstanding debt). §ER equals UR plus temporarily restricted net assets. †Average age of plant equals accumulated depreciation divided by annual depreciation expense. ‡Net available for debt service equals change in UNA plus depreciation expense plus interest expense.

Related Criteria And Research

USPF Criteria: Higher Education, June 19, 2007