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Rating Update: **Moody's affirms St. Mary's College, MD's A2; outlook stable**

Global Credit Research - 12 Aug 2015

\$33M rated debt

ST. MARY'S COLLEGE OF MARYLAND, MD
Public Colleges & Universities
MD

NEW YORK, August 12, 2015 --Moody's Investors Service affirms the A2 rating on St. Mary's College, MD's (St. Mary's) Series 2005A, 2006A, and 2012A bonds, with a final maturity in 2038. The outlook is stable.

SUMMARY RATING RATIONALE

Affirmation of the A2 rating reflects the State of Maryland's solid support for St. Mary's, which serves a unique role as Maryland's only stand-alone public honors college, and the college's improved operating performance. The rating also positively incorporates the college's progress in meeting enrollment targets and manageable debt burden.

Offsetting challenges are the college's small scale, limited ability to grow net tuition revenue due to the highly competitive environment, and minimal flexibility to reduce expenses further without adversely impacting effectiveness. Financial resources and liquidity are also thin for the rating category.

OUTLOOK

The stable outlook reflects our expectation of continued improvement in operating performance, achievement of enrollment targets, continued state support, and no significant increase in debt in the near term.

WHAT COULD MAKE THE RATING GO UP

- Multiple years of meeting enrollment targets, resulting in sustained increases in operating revenue
- Substantial growth in financial resources

WHAT COULD MAKE THE RATING GO DOWN

- Decline in net student charges or return to weak cash flow margins
- Enrollment volatility, with inability to adjust expenses accordingly
- Reduction of financial resources
- Narrowing of debt service coverage by auxiliary revenue

STRENGTHS

- Niche position as Maryland's only solely public honors college, offering a small residential college environment
- Solid, growing support from the State of Maryland (Aaa stable)
- Strengthened operating performance, with 14% operating cash flow margin in FY 2014, driven by expense containment
- Manageable debt, with average debt service coverage of 2.3 times

CHALLENGES

- Weakened market position, reflected by decline in matriculation to 25% for fall 2014, inhibiting net tuition revenue growth

-Limited ability to reduce expenses further given small scale of operations and previous expense reductions

-Weak expendable financial resources for the rating category, which cover operations a low 0.3 times and direct debt 0.6 times

RECENT DEVELOPMENTS

Recent Developments are incorporated into the Detailed Rating Rationale.

DETAILED RATING RATIONALE

MARKET POSITION: ENROLLMENT LOSSES CURTAILED; WEAKER SELECTIVITY AND MATRICULATION

St. Mary's' comparatively small size and relatively high cost structure lead to a challenging market position in an area where there is stiff competition for students. After a 10% decline in enrollment from fall 2010 until fall 2014, the rate of decline has slowed, and the college expects total enrollment of approximately 1,700 students for fall 2015.

St. Mary's' market position remains challenged as it faces high competition with public universities in Maryland as well as private universities in a fragmented and price sensitive market. For fall 2014, the college accepted nearly four-fifths of applicants, providing limited flexibility in its applicant pool, with 26% of accepted students choosing to enroll compared to 32% in fall 2010, highlighting the competitive market and the college's weakened market position.

The college's escalating tuition relative to other colleges and universities over the past 10 years contributed to the decline in demand from a price-sensitive applicant pool. While state support enabled other Maryland public universities to minimize tuition increases, St. Mary's did not receive the same benefits due to its independence from the Maryland higher education system. Over time, the college's increasingly high comparative tuition contributed to the erosion of its market position despite its differentiation in the public marketplace as a small, residential liberal arts college. Increased state funding for St. Mary's allowed a tuition decrease for fall 2014 and flat tuition for fall 2015, making the college more affordable relative to peers than in the past few years.

OPERATING PERFORMANCE, BALANCE SHEET, AND CAPITAL PLANS: IMPROVED OPERATING PERFORMANCE; INCREASED STATE SUPPORT; SOME BALANCE SHEET GROWTH

Expense containment and increased state support resulted in positive operating performance in FYs 2013 and 2014 despite a slight decrease in net tuition revenue. FY 2014's operating margin of 3.4% shows significant improvement from FY 2012's -2.4%, as does FY 2014's operating cash flow margin, which improved to 14.1% from 8.8% two years earlier. Based on preliminary financials, FY 2015 results will be similar to FY 2014.

State support is a credit positive for St. Mary's, with operating support of \$23.5 million in FY 2016, an increase of 24% from FY 2014. St. Mary's historically received a set inflation-adjusted annual block grant from the state. Beginning with FY 2014, the block grant amount was reset in acknowledgment of the college's growth since the initial grant, when St. Mary's enrolled approximately 1,300 students.

Additional future revenue increases, albeit small, will come from the foundation, which will begin providing unrestricted support for the college, estimated at \$200,000 for FY 2016. Overall financial resources, while growing to \$47 million in FY 2014 from \$40 million in FY 2013, are weak relative to peers, with total cash and investments of \$20 million as of FY 2014. As a result, investment income is not a meaningful contributor to revenue diversification.

St. Mary's is currently in a mini-campaign to support a new academic and auditorium facility, which will be funded over seven to eight years with \$70 million from the state and \$2.5 million from the college, of which it has raised approximately \$1 million. Other projects underway on campus are also being funded through the state, including \$15 million for facilities renewal over five years.

Liquidity

Liquidity is limited, with unrestricted monthly liquidity of \$15 million at the end of FY 2014, providing a thin 98 monthly days of cash on hand.

DEBT STRUCTURE AND OTHER LIABILITIES: RATED DEBT ALL FIXED RATE AND CURRENTLY AMORTIZING; \$4M VARIABLE RATE BANK DEBT ADDED IN FY 2015

Debt Structure

The college's \$33 million of rated debt is fixed rate and amortizing through FY 2038. St. Mary's added \$4 million in parity variable rate debt in FY 2015 through an unrated direct purchase with STI Institutional and Government, Inc., ("SunTrust Bank"). These Series 2014A bonds begin amortizing in FY 2016 and will mature in FY 2026.

Debt-Related Derivatives

St. Mary's entered into an interest rate cap agreement with SunTrust Bank in conjunction with the Series 2014A bonds to hedge against possible future interest rate increases. This agreement, which expires May 1, 2020, results in an effective rate cap of 3.3%.

Pensions and OPEB

The college's contributions to pensions and post-retirement health benefits (OPEB) remain manageable within the scope of its operations (combined 5.1% of total expenses in FY 2014); however, the plans are largely controlled by state statute. For pensions, most employees participate in either the State Retirement and Pension System of Maryland (the "System") or one of three defined contribution plans (optional retirement plans, ORP). Although the System is an agent plan, the college's required annual contribution is calculated as though it were a defined benefit plan.

The school's proportionate liability in the state's multi-employer pension plan is currently estimated to be approximately \$10 million. The financial condition of Maryland's retirement system represents a credit challenge for the state. Please see our report on the State of Maryland, dated July 6, 2015, for additional information.

GOVERNANCE AND MANAGEMENT: UNDER NEW PRESIDENT'S LEADERSHIP, UNDERTAKING STRATEGIC PLANNING PROCESS IN FY 2016

A new president took the helm at St. Mary's in fall 2014, replacing an interim president who served for approximately one year. The college also has new leadership in advancement and academic affairs. Now that the college has a full complement of senior level managers, the college is positioned to undertake a strategic planning process, while retaining its identity as a small, place-based liberal arts college.

Budgeting is conservative, based on 97% of anticipated full-time equivalent students, and includes a \$400,000 contingency.

KEY STATISTICS (FY 2014 financial data, fall 2014 enrollment data)

- Full-Time Equivalent Enrollment: 1,771 students
- Total Financial Resources: \$47 million
- Total Pro-forma Direct Debt: \$39 million
- Total Operating Revenue: \$65 million
- Reliance on Student Charges (% of Moody's-adjusted Operating Revenue): 63%
- Monthly Days Cash on Hand: 98 days
- Operating Cash Flow Margin: 14%
- Three-Year Average Debt Service Coverage: 2.3 times

OBLIGOR PROFILE

St. Mary's College of Maryland is Maryland's only solely public honors college and is located in St. Mary's City, Maryland, on the St. Mary River. The college enrolled 1,771 students for fall 2014 and generated operating revenue of \$65 million in fiscal year 2014.

LEGAL SECURITY

The rated Series 2005A, 2006A, and 2012A bonds as well as the unrated Series 2014A are secured by a pledge of academic and auxiliary fees, including tuition and mandatory student fees. The college has agreed to a rate

covenant to fix the fees in each fiscal year in an amount sufficient to pay debt service on the bonds. There is no debt service reserve fund.

For the unrated Series 2014A bonds, a direct purchase by SunTrust Bank, the college is required to maintain a debt service coverage ratio of not less than 1.15 times based on net cash flow from auxiliary enterprises compared to all parity debt. The college is in compliance with the requirement, with an estimated ratio of 1.46:1.00 as of FYE 2015, and we expect the ratio to improve in FY 2016 based on preliminary enrollment.

USE OF PROCEEDS

Not applicable.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. Please see the Credit Policy page on www.moody.com for a copy of this methodology.

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