MOODY'S
INVESTORS SERVICE

Rating Update: Moody's downgrades St. Mary's College of Maryland to A2; outlook stable

Global Credit Research - 09 Sep 2013

$36M debt affected

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

Opinion

NEW YORK, September 09, 2013 --Moody's Investors Service has downgraded St. Mary's College of Maryland (SMCM) to A2 from A1. This rating action impacts $36 million of the Series 2012A, 2006A and 2005A revenue bonds. The outlook is stable at the lower rating. The downgrade is driven by annual enrollment declines from fall 2008 to fall 2013 compounded by a sharp and unexpected drop in fall 2013 freshman matriculants. The recent enrollment and associated revenue challenges significantly impact the college due to its small scale of operations and modest financial reserves.

This rating action concludes Moody's review of St. Mary's rating for downgrade, which was initiated on June 10, 2013.

SUMMARY RATING RATIONALE

The A2 rating reflects the college's niche role as the only solely public honors college in Maryland, its manageable debt burden, stable support from the State of Maryland, and strong financial management team capable of executing necessary expense reductions. The rating also accounts for the college's moderate financial resources and small scale of operations which make adjusting to unexpected revenue declines more difficult. The college is highly dependent on student charges and is further challenged by the highly competitive student market.

The college's weak financial resource base and small size have historically been offset by the college's operating performance, pricing power evidenced by consistently strong net tuition revenue per student growth, and established market niche as the State of Maryland's public honors college. However, the college's recent events have highlighted the need for a stronger levels of reserves to better weather missed revenue and enrollment goals.

The stable outlook at the lower rating reflects the expectation that the university may face modest enrollment challenges in the near term, but will stabilize enrollment and revenues in the longer term as the college finesses its enrollment strategy, hires a new vice president of enrollment, a new director of admissions, and a new college president. The stable outlook also reflects the expectation for stable to improved state appropriations and maintenance of financial resources.

CHALLENGES

*The college reported missing its fall 2013 freshmen and transfer student goal by 150 students in June 2013, which equated to a $3.5 million projected revenue shortfall. As of early September the college is 67 deposits below its goal (roughly 12% of its target).

*The college's position in the highly competitive Maryland market has weakened significantly in recent years, evidenced by two consecutive years of lower than budgeted first-year students (fall 2012 and expected for fall 2013), and six consecutive years of enrollment declines.

*St. Mary's small balance sheet, with expendable financial resources of just $11.2 million in FY 2012, provides a modest cushion to debt and operations of 0.29 times and 0.17 times, respectively.

*The college's relatively high dependence on student charges (66.5%) is a particular challenge given softening of demand and lower enrollment. The college's student charges are already relatively high, limiting additional pricing power.

*Higher fixed costs, evidenced by a very high $26,924 educational expense per student in FY 2012, and limited economies of scale make it more difficult for the college to cut expenses compared to larger public universities.

*The college is in the midst of a presidential transition, with an interim president in place through summer 2014, and will have new management in the enrollment office.

STRENGTHS

*The college receives strong financial support from the Aaa-rated State of Maryland. State appropriations constitute 27.5% of the college's operating revenue, and state appropriations per student are high at $9,178 compared to a median of $5,022 for all A-rated public universities.

*The financial management team executed $3.5 million of campus-wide expense reductions to offset the revenue shortfall resulting from weaker enrollment projected for fall 2013.

*Its niche as a small residential public liberal arts college is a competitive differentiator from other public universities in the state and may contribute to longer-term enrollment stabilization.

*Debt levels have been declining and the college has no current borrowing plans.

DETAILED CREDIT DISCUSSION

DEBT STRUCTURE: All debt is fixed rate with no debt-related derivatives. Bond repayment is secured by a pledge of academic and auxiliary fees, including tuition and mandatory student fees. There is no debt service reserve fund and 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.

RECENT DEVELOPMENTS/RESULTS:

In June 2013, the college announced it missed its fall 2013 freshmen goal by 150 students, which equated to a $3.5 million revenue shortfall. After aggressive outreach, the college now expects to enroll 386 freshman against an original 470 target. The college's enrollment base is small at just under 1,900 students for Fall 2012, and the expected fall 2013 reduction will mark the 6th year of enrollment declines. Management attributes missing the targeted entering class for the past two years to changes in the college's enrollment and recruitment strategies which compounded competitive pressures already developing in prior years. From 2008-2012, applications fell 26% and the college became progressively less selective, accepting 72% of Fall 2012 applicants compared to 52% in for Fall 2008. Leadership of the enrollment office has changed and the college plans to focus more on its traditional target-student population for the Fall 2014 entering class. Our stable outlook anticipates the college will be able to stabilize enrollment and improve student demand as the enrollment and admissions department coalesces around the new strategy and focuses on its core student market.

To balance the FY 2014 budget, the financial management team successfully completed comprehensive campus-wide expense reductions totaling $3.5 million. The expense reductions include approximately $2.4 million of ongoing expense cuts from eliminating 18 vacant positions and decreasing institutional support. Approximately $1.1 million of one-time expense cuts have been made through temporary salary and benefit reductions. In spite of the improved revenue picture with some rebound in the entering freshman and transfer class, the college will still make $3.5 million in expense reductions.

With the revised budget, we expect the college to successfully generate positive operations in fiscal 2014. State funding in Maryland has been favorable and state appropriations are expected to increase modestly in FY 2014 and 2015. The state has allotted a block grant to the college in exchange for a tuition freeze for in-state residents. The block grant is expected to match the revenue the college would have realized had it increased in-state tuition.

Preliminary draft fiscal 2013 results demonstrate improved operating performance over FY 2012. Fiscal 2012 performance was an anomaly as St. Mary's had to draw reserves to remedy a mold issue in two residence halls and fund temporary housing for students, which cost $3.4 million. Fiscal 2013 operations produced a preliminary $1.2 million operating surplus compared to a $1.6 million operating loss in FY 2012. Net tuition revenue declined slightly in FY 2013, however, this was offset by modest increases in state appropriations and auxiliary revenues.

In June 2013 the college's president of three years announced that he would not be renewing his contract. The vice president and dean of admissions and financial aid also left the college in June. The interim VP of enrollment has significant experience in reversing negative enrollment trends at universities, and has done significant work at St. Mary's in the last two months to revitalize the admissions department. The college recently hired a permanent

VP of enrollment, with over 30 years of admissions and recruiting experience, who will start in October. The college also plans to hire a new director of admissions this fall. The board has initiated the process to hire a search firm for a new president. They expect to have a new president hired by Summer 2014.

OUTLOOK

The stable outlook reflects the expectation that the university may face modest enrollment challenges in the near term, but will stabilize enrollment and revenue in the longer term as the college finesses its enrollment strategy under new management. The stable outlook also reflects the expectation for stable to improved state appropriations, and maintenance of financial resources.

WHAT COULD MAKE THE RATING GO UP

Given the college's limited financial resources, small operations, and recent enrollment challenges, an upgrade is unlikely in the short to medium term. Over the longer term positive rating movement could be driven by improved student demand, coupled with significant growth in financial resources and steady operating performance.

WHAT COULD MAKE THE RATING GO DOWN

The rating could be downgraded if there is continued deterioration in enrollment, resulting in ongoing operating losses and depletion of financial reserves.

KEY INDICATORS (FY 2012 financial data, fall 2012 enrollment data)

Full-Time Equivalent Enrollment: 1,895 students

Net Tuition per Student: $12,552

Educational Expenses per Student: $26,924

Average Gifts per Student: $254

Total Cash and Investments: $15.2 million

Total Direct Debt: $38.3 million

Total Comprehensive Debt*: $39.0 million

Expendable Financial Resources to Direct Debt: 0.29 times

Expendable Financial Resources to Operations: 0.17 times

Monthly Days Cash on Hand: 81.3 times

Operating Revenue: $65.2 million

Operating Cash Flow Margin: 8.8%

Three-Year Average Debt Service Coverage: 2.3 times

Reliance on Tuition and Auxiliaries Revenue (% of Moody's Adjusted Operating Revenue): 66.5%

State of Maryland Rating: Aaa stable

* Comprehensive Debt includes direct debt, operating leases, and pension obligation, if applicable.

RATED DEBT

Series 2012A, 2006A and 2005A: A2 stable

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.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

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