Pomona College, CA

New Issue - Moody's assigns Aaa to Pomona College's (CA) series 2017; outlook stable

Summary Rating Rationale
Moody's Investors Service has assigned a Aaa rating to Pomona College's (CA) proposed $129 million of revenue bonds, series 2017. The debt will be issued by the California Municipal Finance Authority. We maintain Aaa ratings on the college's outstanding rated debt. The outlook is stable.

Pomona's Aaa rating reflects the college's extraordinary wealth and liquidity relative to its debt and operating expenses which provides ample financial flexibility. Pomona also has excellent strategic positioning as a nationally known, highly selective liberal arts college with strong fundraising and operations to support strategic investments in programming and capital. Offsetting factors include slow revenue growth with a focus on affordability and diversity, as well as a high reliance on investment income to fund operations.

Credit Strengths
» Ample wealth provides excellent flexibility, with spendable cash and investments over 9x debt and over 11x operations in fiscal 2016, expected to rise further in fiscal 2017
» National academic reputation bolsters very strong student demand evidenced by an over 50% yield on accepted students
» Robust operating performance as a result of careful fiscal management; operating cashflow margins of nearly 30% in each of the last three years through fiscal 2016
» Monthly liquidity is very strong, with 1,896 monthly days cash on hand in fiscal 2016

Credit Challenges
» High, almost 57% operating dependence, on investment returns highlights the importance of prudent endowment management
» Focus on affordability and need blind admissions could limit ability to increase net tuition revenue

Rating Outlook
The stable outlook reflects expectations for continued excellent liquidity, donor support, and strong cash flow to support capital needs.
Factors that Could Lead to an Upgrade

» Not applicable

Factors that Could Lead to a Downgrade

» Substantial increase in financial leverage
» Material decline in liquidity or overall wealth
» Sustained and significant deterioration in operating performance or student demand

Key Indicators

Exhibit 1
POMONA COLLEGE, CA

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<tbody>
<tr>
<td>Total FTE Enrollment</td>
<td>1,582</td>
<td>1,586</td>
<td>1,633</td>
<td>1,639</td>
<td>1,641</td>
<td>1,641</td>
<td>11,205</td>
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<tr>
<td>Operating Revenue ($000)</td>
<td>162,187</td>
<td>167,156</td>
<td>186,355</td>
<td>192,292</td>
<td>199,531</td>
<td>199,531</td>
<td>1,803,364</td>
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<tr>
<td>Annual Change in Operating Revenue (%)</td>
<td>5.8</td>
<td>3.1</td>
<td>11.5</td>
<td>3.2</td>
<td>3.8</td>
<td>3.8</td>
<td>5.9</td>
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<tr>
<td>Total Cash &amp; Investments ($000)</td>
<td>1,937,581</td>
<td>2,095,268</td>
<td>2,357,163</td>
<td>2,347,519</td>
<td>2,261,256</td>
<td>2,261,256</td>
<td>9,920,407</td>
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<tr>
<td>Total Debt ($000)</td>
<td>184,420</td>
<td>184,486</td>
<td>186,921</td>
<td>191,687</td>
<td>203,029</td>
<td>204,183</td>
<td>1,617,221</td>
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<td>Spendable Cash &amp; Investments to Total Debt (x)</td>
<td>8.8</td>
<td>9.6</td>
<td>10.8</td>
<td>10.4</td>
<td>9.3</td>
<td>9.2</td>
<td>6.1</td>
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<tr>
<td>Spendable Cash &amp; Investments to Operating Expenses (x)</td>
<td>12.1</td>
<td>12.4</td>
<td>13.3</td>
<td>12.7</td>
<td>11.4</td>
<td>11.4</td>
<td>7.2</td>
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<tr>
<td>Monthly Days Cash on Hand (x)</td>
<td>2,032</td>
<td>1,894</td>
<td>1,342</td>
<td>1,941</td>
<td>1,896</td>
<td>1,896</td>
<td>726</td>
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<tr>
<td>Operating Cash Flow Margin (%)</td>
<td>30.0</td>
<td>26.1</td>
<td>29.7</td>
<td>29.4</td>
<td>29.1</td>
<td>29.1</td>
<td>20.6</td>
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<tr>
<td>Total Debt to Cash Flow (x)</td>
<td>3.8</td>
<td>4.2</td>
<td>3.4</td>
<td>3.4</td>
<td>3.5</td>
<td>3.5</td>
<td>4.8</td>
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<tr>
<td>Annual Debt Service Coverage (x)</td>
<td>5.4</td>
<td>4.8</td>
<td>7.1</td>
<td>7.2</td>
<td>7.2</td>
<td>7.2</td>
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Pro forma includes series 2017 debt against fiscal 2016 financials.
Source: Moody’s Investors Service

Detailed Rating Considerations

Market Profile: Strong demand with national reputation as elite liberal arts college

Pomona will maintain solid national student demand as it employs its considerable resources to invest in programming and financial aid to attract an academically strong and diverse student body.

The college is committed to need-blind admission and fully meeting the financial needs of admitted students, providing it a competitive advantage, but leading to a high 49% tuition discount rate in fiscal 2016, estimated to have risen to 51% in fiscal 2017. Nonetheless, net tuition per student has consistently grown in the 2-4% range annually over the last five years.

Demand is exceptionally strong, with only 8% of applicants admitted for fall of 2017, and 55% of those admitted choosing to enroll.

Operating Performance: Very strong cash flow through careful budgeting

Pomona will continue to generate excellent annual operating margins, adding strong operating flexibility to grow reserves and make strategic investments. The college’s strong fiscal stewardship with careful budgeting and a low endowment spend rate bolster operating performance. From fiscal 2014-2016, Pomona had a three-year average operating margin of 18%, and operating cash flow of nearly 30% (when removing a one-time $14 million reclassification of net assets from operating revenue in FY 2016). We anticipate similar results in fiscal 2017, although margins are likely to be slightly weaker due to increased financial aid.

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A low endowment spend rate and careful investment management are especially important in light of almost 57% operating dependence on investment income in fiscal 2016. Pomona has actively reduced its endowment spend rate to align with the expected lower long-term return environment. For fiscal 2017, its budgeted endowment spend rate was 4.5%.

**Wealth and Liquidity: Exceptional reserves underpin Aaa rating**

Ample cash and investments relative to debt and operations, as well as solid fundraising to support future initiatives are key credit factors for Pomona's Aaa rating. At June 30, 2016, cash and investments totaled $2.3 billion, adding considerable financial flexibility, especially relative to Pomona's small operating scale of just $166 million of operating expenses. Financial reserves are expected to rise further in fiscal 2017 given a healthy 13% return on investments.

Fundraising is solid despite not being in a campaign, with $31 million of three-year average annual gift revenues and average annual gifts per student of $19,100 for fiscal 2014 - fiscal 2016. The college is currently fundraising for its Museum of Art project - a $44 million project for which it has raised $20 million.

Pomona's endowment return has been on par with peers. As of June 30, 2017 the one-year return was a strong 13.1% and a turnaround from the negative 3.0% in the prior year. Like other similarly sized endowments, the asset allocation is substantially weighted toward hedge funds and alternative investments. While management has not provided a detailed list of manager positions to Moody’s, the information they have provided indicates no single manager holds more than around 8% of the portfolio.

Investments are overseen by an active investment committee of the board, with external investment advisors, and day-to-day functions handled by a small internal staff of around 2 full-time professionals. Pomona engages in careful investment management with decreasing return rate assumptions, low endowment spending, and regular monitoring and evaluation.

**LIQUIDITY**

Pomona has ample liquidity with which to manage its operating, capital, debt service and investment needs. At June 30, 2016, the college had approximately $770 million of unrestricted monthly liquidity, which equates to 1,896 monthly days cash on hand.

Unfunded commitments within the endowment have risen sharply in the last two years, but still represent a manageable 11% of total cash and investments.

**Leverage: Moderate debt offset by strong cash flow**

Leverage will remain moderate due to the college's strong balance sheet cushion and healthy cash flow. Debt to operating revenue is high at 1.0x, but offset by strong reserves. Debt affordability is good, with debt to cash flow of 3.5x and below the Aaa-rated private university rating median of 4.5x. The revenue bonds currently being rated will include around $20 million in new money to contribute to the cost of renovating the college's Museum of Art and do not appreciably affect proforma debt ratios. Furthermore, given expected growth in financial reserves in 2017, we anticipate some improvement in the spendable cash to debt ratio.

Future capital needs are manageable, with an estimated just over $200 million of potential projects in the next five to ten years. Pomona also carefully manages its campus renewal needs and sets aside $3-4 million from the annual operating budget for deferred maintenance and other projects.

**DEBT STRUCTURE**

Pomona’s debt is all fixed rate, but has large bullet maturities in the coming years (2018, 2019 and 2024) which require continued strong cash flow and careful reserve management. The forthcoming series 2017 bonds will refund the series 2008A coming due in fiscal 2018 and the series 2009A bonds coming due in fiscal 2019 and 2024 for a total of around $110 million. The college has two private placement loans: one for $14 million with First Republic Bank that matures on July 1, 2044; and a second $17 million loan with Boston Private Bank & Trust Company, to refund a portion of the Series 2005A bonds, which matures on July 1, 2045. The forthcoming series 2017 will be fixed rate, with interest only payments for the first ten years followed by increasing principal payments over the next 20 years in its 30 year maturity.

**DEBT-RELATED DERIVATIVES**

None.
PENSIONS AND OPEB
Pension expenses claim a moderate portion of the college's budget. The college participates with other members of The Claremont Colleges in a defined contribution plan administered by the Claremont University Consortium. Pomona's share of contributions were $6.3 million in FY 2016, or a manageable 3.8% of total expenses.

Governance and Management: New president, careful budgeting, thoughtful approach to planning
Pomona's careful budgeting, strong long-term planning, with scenario modeling and a holistic approach to sustainability bolster the college's credit strength. A new president began her term on July 1, 2017, and inherits a strong senior leadership team with mixed tenure at the college.

Legal Security
The bonds are an unsecured general obligation of the college.

Use of Proceeds
Proceeds will be used to refund outstanding debt, fund an upgrade to the museum, and pay issuance costs.

Obligor Profile
Pomona College is a small elite liberal arts college with 1,641 full time equivalent students and approximately $200 million in operating revenue. The college is located in southern California, outside of Los Angeles and is one of The Claremont Colleges, a consortium of five colleges, two graduate institutions, and a central coordinating entity that provides services to all members.

Methodology
The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

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<th>Exhibit 2</th>
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<td><strong>Pomona College, CA</strong></td>
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<td><strong>Issue</strong></td>
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<td>Revenue Bonds Series 2017</td>
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<tr>
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<td>Sale Amount</td>
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<td>Expected Sale Date</td>
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*Source: Moody's Investors Service*
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