Fitch Affirms Pomona College, CA's Revs at 'AAA'; Outlook Stable

Fitch Ratings-New York-22 October 2019: Fitch Ratings has assigned an Issuer Default Rating (IDR) of 'AAA' to Pomona College. In addition, Fitch has affirmed the 'AAA' rating on approximately $179.7 million of outstanding revenue bonds issued by the California Educational Facilities Authority (CEFA) on behalf of Pomona College.

The Rating Outlook is Stable.

SECURITY

The bonds are an unsecured general obligation of the college, payable from all legally available funds.

ANALYTICAL CONCLUSION

The 'AAA' Issuer Default Rating (IDR) and revenue bond ratings reflect Pomona College's exceptional demand profile, robust financial profile, and excellent fundraising track record. The Stable Rating Outlook reflects Fitch's expectation that the college will maintain strong adjusted cash flow margins in the coming years in line with historical trends, and that its exceptional balance sheet strength will be preserved.

KEY RATING DRIVERS

Revenue Defensibility: 'aaa'; Exceptional demand characteristics with broad geographic reach

Pomona's demand assessment is 'aaa' due to its exceptional demand indicators, national/international student draw and reputation for academic excellence, as demonstrated by increasing applications, very selective admissions, and a steady, solid freshmen matriculation rate. The college's adjusted operating revenues have a heavy reliance on investment income/endowment spending, generated by its pooled investment fund, in addition to student-driven charges, which are expected to be sustainable at current levels.

Operating Risk: 'aaa'; Exceptionally strong margins and strong fundraising

Pomona has exceptionally strong operating cost flexibility as demonstrated by very robust cash flow margins (36.7% and 35% in fiscals 2018 and 2017, respectively). Pomona's consistently high margins are largely driven by a high proportion of endowment spending and net assets released from
Financial Profile: 'aaa'; Substantial financial cushion

Pomona's extremely strong financial profile is driven by a substantial measure of available fund to adjusted debt of 964% in fiscal 2018. Fitch expects financial leverage to remain consistent with a 'aaa' financial assessment profile through the cycle assuming moderate near-term capital spending needs, and with demonstrable resilience through Fitch's stress case scenario, which includes changes in market value of the investment portfolio over the course of a market or economic downturn.

Asymmetric Additional Risk Considerations

No asymmetric risk considerations affected the rating.

RATING SENSITIVITIES

PRESERVATION OF FINANCIAL RESOURCES: Material erosion of Pomona's substantial financial cushion and/or a material change in adjusted cash flow margins, while not expected, could pressure the rating.

CREDIT PROFILE

Founded in 1887, Pomona is a small, private independent liberal arts college located in Claremont, CA and a founding member of an affiliated group of colleges known as The Claremont Colleges. However, Pomona is a separate corporate entity governed by a separate board of trustees. Pomona is largely an undergraduate college, offering 49 majors in natural sciences, humanities, social sciences and fine arts. The college is highly selective, with a prestigious national reputation and very strong student demand that continues to improve. Pomona's new president began her tenure in early fiscal 2018. The college is currently working on a new strategic plan that is expected to be completed by the end of fiscal 2020.

Revenue Defensibility

Pomona's demand profile is consistent with a 'aaa' assessment. The college has very selective admissions, with broad national/international demand, exceptional student quality, and a strong liberal arts academic reputation.

In fall 2019, Pomona's admissions are very competitive with a very selective freshman acceptance rate of 7.4%, and a similarly strong freshmen-to-sophomore retention rate consistently above 90%. Pomona's freshman matriculation has steadied in the mid 50% range in recent years and the entering freshman class is of superb student quality with SAT and ACT scores averaging 1470 and 33 in fall 2019, both in the top decile of the national average and also consistent with a 'aaa' assessment.
In-state students account for about 26% of Pomona's undergraduate enrollment, with the remaining 74% supportive of a national and international geographic reach. Management reports that the international cohort, generally about 10% of the applicant pool, is broad but shrinking due to issues around immigration and related issues. Given the institutions need-blind admissions policy and increasing institutional aid requirements, full-pay international students aid in stabilizing net tuition revenues, which have declined in recent years. Management reports new initiatives around growing this cohort.

Student-generated revenues made up the second largest revenue source at 26.8% of revenues in fiscal 2018, with investment and endowment income appropriated for operations representing the college's largest revenue source, averaging a sizable 43% of total operating revenues during the past five fiscal years. Net assets released from restrictions (26%) and gifts and contributions (3%) together are also relatively large, they are expected to help stabilize but not fully counter volatility in other revenues going forward.

To mitigate significant reliance on endowment/investment income, Pomona transitioned from a 12-quarter endowment spending policy to a 20-quarter market value average in fiscal 2017, spending between 4.5% and 5.5%. These adjustments are expected to moderate spending growth. Over the long term, Pomona expects this policy will allow its endowment to maintain its purchasing power by growing at a rate at least equal to planned payouts. Additional real growth will be provided through new gifts and any excess investment return.

For fiscal years ended 2018 and 2017, the board of trustees authorized distributions of $93 million and $89 million, based on an approved spending rate of 4.8% and 4.5%, respectively, for current operations from the net realized investment gains of pooled investments. Periodic draws are generally at levels comfortably below expected annual long term investment returns based on the current asset allocation (one-year 2019 returns were 6.5%). Fitch expects these annual draws to be sustainable over time.

Pomona's adjusted cash flow margins climbed to a remarkable 36.7% in fiscal 2018. Management reports consistently positive results for fiscal 2019, with strong growth in operating revenue driving growth in resources. There is some variability expected going forward, which is not unusual given the high proportion of investment income, but performance is expected to remain consistently strong.

Pomona reports capital spending plans of about $120 million over the next-five years, including two major projects described below, which Fitch views as moderately large relative to operating revenues ($143.7 million in fiscal 2018, excluding the endowment draw), though the college expects some flexibility with respect to timing for major capital costs. Pomona's financial flexibility, prudent facilities planning and exceptional fundraising capabilities are all mitigating factors offsetting the college's stated capital plans.

Major capital projects include a $55 million gymnasium/wellness center which is expected in the near-term; the college is also evaluating a $60 million international residence hall/dining center which is a major priority but not certain as to timing. Capital needs will be funded by a mix of gifts and internal reserves, although some level of debt may be considered for a dormitory/dining project.

Overall, Pomona's lifecycle investment needs are viewed as moderate as assessed through an average age of plant of 11.6 years.
Pomona has a very strong track record of fundraising; the college is currently between campaigns. The college's previous major campaign "Daring Minds" ended in fiscal 2016, raising $317 million over a five-year period and exceeding its goal of $250 million. The majority of the campaign was designated for financial aid, the rest for facilities and academic programs. Pomona funds about 60% of its institutional aid; the remaining 40% is sponsored aid which is funded by external entities (donors of restricted funds).

Fundraising momentum has continued post-campaign. Pomona received a $15 million gift for a new art museum (completed in September 2019) and two additional gifts totaling $2-3 million. Overall gifts represented about 75% of the museum's total cost, which was also funded with a portion of debt proceeds issued in 2018 (series 2017A). The college also runs a successful annual fund, typically budgeting for $4.5 million per year in unrestricted gifts.

Financial Profile
Pomona's financial profile is extremely strong in the context of the college's 'aaa' revenue defensibility and 'aaa' operating risk profile assessments. Leverage-related ratios are remarkably strong through the cycle in Fitch's forward-looking FAST scenario analysis, including in the stress case.

Available funds (AF) measured about $2.18 billion at fiscal year-end (FYE) 2018 (Fitch defines AF as unrestricted cash and investments less permanently restricted net assets). The college's AF-to-adjusted debt measured extremely high at 964% at FYE 2018. Pomona's adjusted debt totals $226 million at FYE 2018 and includes outstanding revenue bonds ($180 million), unamortized bond premium ($15.7 million) and two bank loans ($30.6 million).

Pomona's leverage-related ratios are very strong through the cycle in Fitch's FAST scenario analysis, with AF to adjusted debt remaining very high. AF-to-operating expenses measured a remarkable 1237% at FYE 2018.

Pomona's debt service is level through 2028 then gradually ascending through maturity. In fiscal 2018, Pomona issued series 2017A tax-exempt bonds through the California Municipal Finance Authority (CMFA). The majority of the proceeds were used to refund series 2008A and series 2009A bonds. The bonds restructured debt and smoothed out very large bullet maturities. The remaining proceeds of about $26 million were used to provide partial funding for the new Pomona College Museum of Art. Pomona's outstanding notes payable totaling $30.6 million include two private placement tax-exempt credit facilities with First Republic Bank and Boston Private. Both facilities are fixed rate term loans amortizing over 30 years.

Asymmetric Additional Risk Considerations
No asymmetric risk considerations affected the rating.

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Applicable Criteria
Public Sector, Revenue-Supported Entities Rating Criteria (pub. 28 May 2019)
U.S. Public Finance College and University Rating Criteria (pub. 03 Jun 2019)

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