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

Fitch Ratings-New York-30 April 2015: Fitch Ratings affirms the 'AAA' rating on approximately \$182 million of outstanding revenue bonds issued by the California Educational Facilities Authority (CEFA) on behalf of Pomona College (Pomona).

The Rating Outlook is Stable.

SECURITY

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

KEY RATING DRIVERS

STRONG FINANCIAL PROFILE: The 'AAA' rating primarily reflects Pomona's significant level of balance sheet resources, evidenced by its strong liquidity relative to debt and operations, and robust fundraising capabilities offsetting a moderately high debt burden, high financial aid needs and significant reliance on investment income/endowment spending.

EXCEPTIONAL DEMAND: The college benefits from a prestigious reputation for academic excellence which draws very strong student demand, demonstrated by increasing applications, very selective admissions and a steady, solid freshmen matriculation rate at 48%.

HEALTHY OPERATIONS: Pomona's operating margins are generally positive inclusive of endowment spending; however, operating performance is increasingly reliant on endowment distributions and investment returns generated by its pooled investment fund.

MANAGEABLE FINANCIAL LEVERAGE: Pomona's moderately high debt burden and non-level debt maturities structure with very large bullet payments coming due in fiscal 2018 is offset by a track-record of generating sound debt service coverage from operations (inclusive of endowment spending) and the college's vast resources and prudent debt management.

RATING SENSITIVITIES

PRESERVATION OF FINANCIAL RESOURCES: A material erosion in Pomona's strong financial cushion and/or material change in operating results, inclusive of endowment spending, significantly driven by investment returns, could negatively affect the rating.

CREDIT PROFILE

Founded in 1887, Pomona is a small private, independent co-ed liberal arts college, located in Claremont, CA, and a member of an affiliated group of colleges known as the The Claremont Colleges. However, Pomona is a separate corporate entity governed by a separate board of trustees. Pomona is solely an undergraduate college, offering 45 majors in natural sciences, humanities, social sciences and fine arts. The college is highly selective with a prestigious national reputation and strong student demand that continues to grow. Fall 2014 headcount enrollment totaled 1,650 students.

HEALTHY FINANCIAL PROFILE

Pomona's impressive balance sheet liquidity and moderate financial leverage underpins its 'AAA' rating. As of June 30, 2014, available funds, defined by Fitch as cash and investments not permanently restricted, totaled \$2.01 billion. Available funds covered fiscal 2014 operating expenses (\$151.4 million) and pro forma debt (\$216.2 million) by a very strong 13.3 times (x) and 9.3x, respectively. Pro forma debt is inclusive of Pomona fully drawing down on a \$25 million tax-exempt private placement bank facility which is anticipated to occur in fiscal 2015.

Similar to many private colleges and universities with like-sized endowments, Pomona has significant (over 60%) exposure to alternative, illiquid asset classes. Excluding these investments, the college's adjusted available funds

would still provide strong coverage of both operations and debt by 5.0x and 3.5x, respectively. Moreover, the market value of the college's pooled investment fund grew to approximately \$2.2 billion as of Feb. 28, 2015 (unaudited).

INVESTMENT INCOME DRIVES OPERATIONS

Pomona continues to be heavily reliant on investment returns generated by its pooled investment fund to support operations. Investment income and endowment income appropriated for operations represents the college's largest revenue source, averaging over half of total operating revenues over the past five fiscal years. Student-generated revenues comprise the second largest revenue source and average just over one third of revenues.

Inclusive of endowment spending, Pomona's operating results have mostly been positive averaging 4.5% for the last five fiscal years (2010-2014). Pomona's endowment distribution amount increased 5% to \$72.1 million to support fiscal 2014 operations. Fitch notes Pomona has a 12-quarter average endowment spending policy, which is currently at 4.5%, which is the floor of its policy to spend between 4.5% and 5.5%. Fitch views this as a sustainable level.

Pomona's operating performance, including the distribution in fiscal 2014, was negative \$4.03 million (or -2.7%), compared to a \$3.5 million surplus (or 2.47%) in fiscal 2013. Operating margins are significantly understated when excluding net assets released from restrictions which are not broken out in the audited financial statement and includes capital. According to management, net assets released for operations in fiscal 2014 were about \$38.5 million, significantly increasing Pomona's margin to 18.5%.

Based on preliminary projections as of Dec. 31, 2014, Pomona anticipates a fiscal 2015 operating surplus of more than \$2.3 million including an endowment distribution of approximately \$75.5 million for operations. The college's fiscal 2016 operating budget is not yet finalized but is expected to reflect another modest increase in endowment spending.

STRONG DEMAND

Per Fitch's rating methodology, stable-to-growing enrollment trends are viewed favorably. Pomona continues to reflect strong demand with total headcount enrollment in fall 2014 reaching 1,650, which is 2.4% above the prior year and 5.8% above fall 2010 levels. Pomona's demand strength is fueled by its extremely high selectivity, demonstrated by a fall 2014 acceptance rate of 12.2%. The matriculation rate remained steady, averaging 41.7% over the past five fall enrollment cycles.

To date, the college has received approximately 8,100 total freshmen applications for fall 2015, about 4.8% more than applications received for fall 2014. Pomona is also running ahead of last year in admits and deposits. According to management, Pomona's freshmen class in fall 2014 of 451 exceeded budgeted enrollment of 400. Pomona expects a smaller incoming class in fall 2015 of around 405 keeping with its goal to maintain its small size at approximately 1,600 students. This level allows Pomona to provide a residential experience for all levels of enrolled students given the college's mandatory housing requirement.

Fitch considers Pomona's enrollment goals to be reasonable and achievable, given past enrollment trends and favorably trending year-to-date admissions statistics for fall 2015.

MANAGEABLE DEBT BURDEN

Pomona currently maintains an entirely fixed-rate debt portfolio, which contains several bullet maturities. The college's pro forma maximum annual debt service (MADS) is very high at approximately \$76 million, including a large bullet payment due in fiscal 2018 which is an extremely high 51.6% of fiscal 2014 adjusted operating revenues (inclusive of endowment distributions).

As MADS includes a large bullet payment, Fitch also analyzed the debt burden based on average annual debt service (AADS). AADS is significantly more manageable at about \$10.02 million resulting in a drastically reduced debt burden of 6.8%. Fitch still views this level as moderately high but manageable as demonstrated by sufficient AADS coverage of 1.64x based on fiscal 2014 net income of \$16.4 million.

Fitch expects Pomona will utilize its considerable resource base and market access to address large bullet payments prior to maturity. Use of non-level amortization schedules is also not atypical for highly rated institutions,

especially those with significant resources.

In June 2014, Pomona's entered into a private placement tax-exempt credit facility with First Republic Bank and California Municipal Finance Authority which allows the college to draw down up to \$25 million over a two year period, which is included in the calculation of debt service above. After three-years, the facility converts to a fixed rate term loan amortizing over 28 years. To date, about \$4.3 million has been drawn under the facility and about \$21 million is expected to be drawn by June 2015 which will be used for completion of a committed project under the current capital plan. Together with the converted bank loan, Pomona will have about \$217 million in fixed rate debt outstanding, including outstanding revenue bonds (\$191.2 million).

Pomona's potential future debt plans include a restructuring for existing debt to smooth out two very large bullet maturities coming due in fiscal 2018 and 2019. Longer-term capital needs totaling \$35 million for a museum project are anticipated to be fully funded by gifts and internal reserves, although some level of debt may be considered but this would be several years away.

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In addition to the sources of information identified in Fitch's U.S. College and University Rating Criteria, this action was informed by information from Bank of America Merrill Lynch, the underwriter.

Applicable Criteria and Related Research:

- '2015 Outlook: U.S. Colleges and Universities' (Dec. 4, 2014);
- 'Revenue-Supported Rating Criteria' (June 16, 2014);
- 'U.S. College and University Rating Criteria' (May 12, 2014).
- 'Fitch Rates Pomona College (California) Revs at 'AAA'; Outlook Stable' (May 17, 2013).

Applicable Criteria and Related Research:

2015 Outlook: U.S. Colleges and Universities (http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=817308)
Revenue-Supported Rating Criteria (http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=750012)
U.S. College and University Rating Criteria (http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=748013)

Additional Disclosure

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