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Unprecedented Times And Uncertainties Test U.S. Private Primary And Secondary Schools

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Unprecedented Times And Uncertainties Test U.S. Private Primary And Secondary Schools

Standard & Poor's Ratings Services believes that credit trends in the world of independent private schools have changed significantly in recent months, shifting from a positive outlook early in the year toward a more cautious view. By the end of third-quarter 2008, we observed that the global economic crisis had weakened some of the sector's positive momentum. While we believe that overall credit quality remains relatively stable, troubling trends are emerging. Lower liquidity levels and weaker investment performance are what we see as the key issues the sector faces currently. Other concerns relate to economic dislocation, including access to student loans, schools' access to capital markets, and parental affordability. We expect these issues and concerns to create budget challenges for the remainder of fiscal 2009. Additionally, in our view, the schools will have significant operating challenges for fiscal 2010.

We believe the favorable trends of 2007 and early 2008 reflected a culmination of high levels of fundraising, positive investment returns, and solid demand. This environment enabled many institutions to have market access to cost-effective tax-exempt debt so that they could borrow at relatively low interest rates and make major campus and program improvements, further enhancing the sector's credit strength. We believe these positive developments spurred a major improvement in the sector's overall credit quality, which translated into an increase in rating upgrades (five) relative to downgrades (one) since January 2007.

Challenges Ahead As Economy Sours

Weaker endowment returns

Despite the positive movement in ratings in 2007 and over the first half of 2008, we believe the U.S. private school sector now faces a number of challenges. First, we saw weaker endowment returns for fiscal 2008, as many institutions reported negative returns for the fiscal year ended June 30, and when adjusted for endowment spending, some institutions--especially those with what we consider to have weak fundraising results--are showing significantly lower endowment market values. Furthermore, as of Nov. 30, many institutions are reporting investment portfolio losses between 20% and 30%, excluding valuation of certain asset classes such as private equities and real estate, which we also expect to have significant weakness.

Risky debt exposure

We also note that many institutions have had what we consider a high amount of variable-rate-debt exposure in their debt portfolio--most backed by letters of credit. Following the downgrades of several monoline insurers as well as downgrades and bankruptcies in the banking industry, interest rates have increased, which led to higher-than-expected interest costs for many schools in both fiscal 2008 and so far in 2009. Thus, many institutions are now dealing with much higher interest rates than originally planned and for many institutions rated 'AA' and lower, there is a premium from previous years paid to convert to fixed debt.

We are more concerned with bank bond risk--specifically when a bond issue becomes a bank bond after it is unsuccessfully remarketed and is "put" back to the standby bank (see "S&P Explains Its Approach To Rating 'Bank Bonds'," published Oct. 2, 2008, on RatingsDirect. We view bank bonds as a significant credit risk as some might mature within five years, putting extreme pressure on institutions.

Limited liquidity

We also see liquidity as a major issue for some rated schools in recent months, partly due to Wachovia's decision to close the $9.3 billion Commonfund Short Term Fund (see "Wachovia's Closing Of The Commonfund Short Term Fund Could Affect Ratings On Higher Education," published Oct. 2, 2008, on RatingsDirect. In addition, some money market funds "broke the buck" in September 2008 by reporting a per-share value of less than one dollar causing more liquidity issues. Our analysis reveals that the majority of rated colleges and universities and rated private independent schools have invested in the Commonfund Short Term Fund. The major risk associated with Commonfund investments, in our view, is short-term limited cash flow: Institutions used the fund as a source of liquidity for variable-rate demand bonds and commercial paper as well as short-term investment for working capital and operational funds. Many institutions deposited their fall semester tuition and fees in this fund, expecting to use the money for payroll and other operating expenses. Standard & Poor's has learned that the fund expects to return, over time, full principal to institutions invested in the fund. Of the Standard & Poor's rated institutions, all Commonfund-related liquidity issues as well as other money market fund issues appear to be resolved.

Weaker operating performances

Operating performance is a major concern for 2009 and 2010. More institutions are currently dealing with large investment losses and tough decisions regarding this year's budget as well as next year's budget. With the recent crisis, many institutions will have to adjust to the current reality of permanent or long-term investment losses to their endowments--a source of revenue on which many private schools depend. We believe this situation may force some institutions to deal with major expenditure cuts as well as some restructuring. In addition, because of the global economic crisis, we may see fewer gifts and smaller gift amounts, which will put increasing pressure on operations.

Parents strapped for cash

We also remain concerned about parents' ability to pay for a private school education. Given current market conditions, it appears that many lenders have decided to exit the market or limit access to new loans due to underlying credit concerns. In such situations, institutions will need to find ways to maintain enrollment levels by limiting attrition and attracting new students. In addition, given that many parents have experienced a rapid decline of wealth in the past few months, we could see a higher budget for financial aid at many schools, which will result in lower net tuition revenues. As a result, this would further challenge a school's operating budget.

The Sector's Rating Outlook

Our outlook for this sector is cautiously stable in terms of rating changes, but somewhat more mixed than it has been in previous years. We expect that most institutions will navigate through these tougher times without major rating implications. However, our view of the lower-rated and speculative-grade institutions is somewhat mixed.

The sectors' debt-issuance volume remained fairly stable in 2007 as well as in the first nine months of 2008. Much of the volume came from what we see as a significant increase in the number of refinancings, as many institutions restructured their debt portfolio and developed new capital programs. However, we note there has been very little issuance since August, mainly because of volatile capital markets, plus higher interest rate costs demanded by investors for institutions rated less than 'AA'.

Nevertheless, we believe we could see relatively high debt issuance when the markets return to a more stable environment. We have also observed more requests for Standard & Poor's underlying ratings (SPURs) as well as stand-alone ratings without insurance, stemming from the elevated need for credit information.

New Ratings

Standard & Poor's assigned ratings to several new independent schools in 2007 and 2008 (e.g., Kent School and Pomfret School, both in Connecticut), including private ratings, issuer credit ratings, or credit assessments provided in some cases. The independent schools rated by Standard & Poor's represent a relatively small portion of our education and nontraditional, not-for-profits sector. Of the roughly 100 rated obligors, Standard & Poor's provides 52 public ratings.

Ratings Changes In 2007-2008

Since the start of fiscal 2007, we upgraded five institutions and downgraded one in the independent school sector.

- Cambridge Friends School, Mass. (April 2007). We lowered the debt rating on Cambridge Friends School to BB+/Stable from BBB-/Stable based on what we consider a substantial decline in student enrollment as reported by management and much weaker demand flexibility. In addition, the school has reported what we consider weak financial results, including six consecutive years of unrestricted net asset deficits and deteriorating liquidity levels.
- Crossroads School, Calif. (August 2007). We raised the debt rating on Crossroads School to A+/Stable from A/Positive based on operational surpluses and liquidity, which, in our opinion, have shown considerable improvement during the past three years.
- Nightingale-Bamford School, N.Y. (June 2007). We raised the debt rating on Nightingale-Banford School to A+/Stable from A/Positive based on what we consider strong liquidity, impressive student demand, and a history of balanced operations.
- Peddie School, N.J. (September 2008). We raised the debt rating on Peddie School to AA+/Stable from AA/Positive based on management's report of a significant increase in unrestricted resources due to the reclassification of Walter H. Annenberg's 1993 donation to the school and in our view, strong operating performance. Management has not reported additional debt plans but has indicated continued improvement in the school's student demand.
- Westtown School, Pa. (September 2006). We raised the debt rating on Westtown School to A/Stable from A-/Stable based on what we consider strong and growing liquidity levels, which resulted in favorable levels of expendable resources per student relative to operations. Management also reported what we deem to be favorable operating results, strong and stable demand characteristics, and manageable debt levels.
- Wheeler School, R.I. (April 2008). We raised the debt rating on Wheeler School to BBB/Stable from BBB-/Stable based on what we consider a significant increase in financial resources, impressive fundraising results over the past two years, and, in our view, strong operating performance.

Ratio Trends For Fiscals 2007-2008

Steady demand for most rated institutions

We expect demand levels for our rated institutions to remain stable because many independent schools do not have plans to expand enrollment. In addition, during the past five years, many schools have successfully increased their level of applicants and strengthened their acceptance rates, allowing a degree of flexibility they may now need.

Nevertheless, in our view, independent schools rely heavily on tuition and fee income with a majority of investment-grade-rated schools having, on average, 67% of their operating revenues for fiscal 2007 come from tuition and fees.

Boarding schools versus day schools

Boarding schools also enroll day students, which tend to offset declines in boarding-student enrollments. According to our data, on average, 32% of students attend boarding schools as day students. However, the traditionally high cost of boarding school, coupled with the current tough economic times remains one of our concerns.

Compared to boarding schools, we believe private schools that only enroll day students have greater exposure to economic risk because of their increased dependence on student-generated revenues. Dependence on student-generated revenues results in less financial flexibility. In addition, day-student-only schools rely on a smaller geographic draw, increasing exposure to demographic and geographic-specific economic volatility.

Financial resources

Looking back at fiscal 2007 and the past three years, independents schools' financial resources remained relatively stable, reflecting what we consider strong endowment performance. We believe this growth in financial endowment helped schools improve their financial operations and resource levels, allowing schools to add significant debt over the past five years.

The situation changed, however, beginning in early fiscal 2008, and likely will have a varied level of impact depending on the institution, in our view. Many institutions' long-term investments experienced a significant decline in returns. We expect this trend to carry through fiscal 2009. While this downward trend on investments returns hurts all market participants, those institutions that have financial strategies and plans tied to strong endowment growth to support operations and capital plans will be hurt most. Schools with capital plans focused on immediate critical needs will be under the greatest pressure to enter the debt market in less-than-favorable conditions.

Fundraising efforts

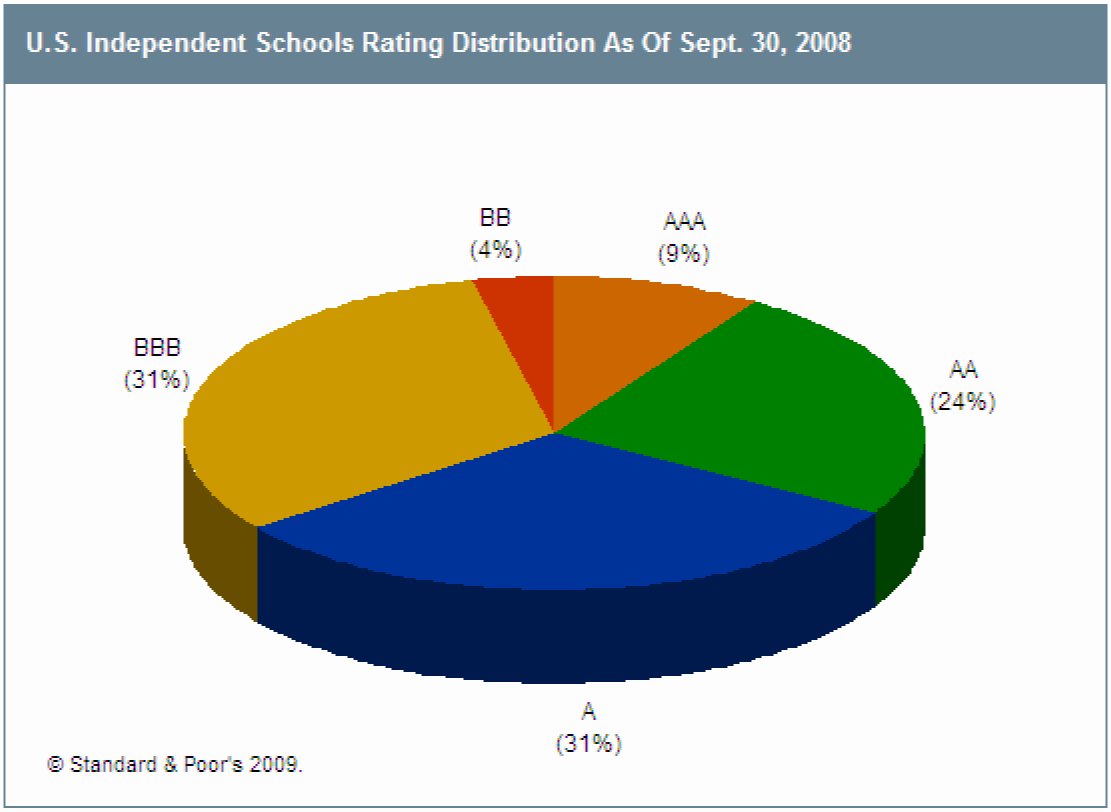
As a result of successful fundraising efforts, schools have recorded record levels of giving at many institutions in recent years. Recent reports highlighted a reduction in the numbers of alumni giving to schools, but an increase in the number of major gifts to institutions. Gift giving continues to play, in our view, a major role in the growth of endowment as well as providing support for the operating budget. The school's campaigns are stressing the need for increased financial aid and faculty salaries as well as some capital improvements. The unrestricted annual fund provides significant support to annual operating budgets and allows schools operational flexibility in managing their resources throughout the academic year.

Managerial challenges

We believe that management challenges for independent schools continue to grow as the operating environment becomes more complex. The complexity, discussed in more detail in "An Insider's View Of The State Of Independent Preparatory Schools," published Aug. 6, 2008, on RatingsDirect, rises from the success of independent schools over the past five years and the changing business and economic environment. In our view, the skills and leadership required for the board of trustees and at the executive management level have become highly sophisticated and necessary to enable members to continue to thrive.

Rating Criteria

Chart 1



Quantitative factors

When assigning a rating, we consider factors that are congruent for all independent schools. However, we do compare some factors relative to an institution's peer group, which accounts for the differences in rating categories. These factors include, but are not limited to, a school's demand profile, niche and competitive position, financial resources and debt burden relative to the overall size of its operation, and ongoing financial performance and flexibility. The independent school ratios, presented in tables 1 and 2 reflect these institutional differences.

Table 1

U.S. Independent Schools Financial Statistics For 2007*

	—Rating Category—			
	AAA	AA	A	BBB
	Demand			
Total headcount				
Mean	773	633	849	696
Median	608	568	668	590
Freshman selectivity ratio (%)				
Mean	19.8	29.0	48.3	60.6
Median	20.3	26.9	46.6	61.1

Table 1

U.S. Independent Schools Financial Statistics For 2007* (cont.)

Freshman matriculation ratio (%)				
Mean	65.5	69.3	63.7	64.7
Median	67.4	65.7	61.4	65.6
	Revenue diversity			
Tuition dependency (%)				
Mean	47.4	54.4	65.5	78.9
Median	47.6	52.2	65.2	78.8
Investment and endowment income as a percentage of revenue (%)				
Mean	22.2	19.6	7.6	3.8
Median	23.2	10.6	5.8	3.7
	Financial aid			
Financial aid burden as a percentage of expenses (%)				
Mean	13.3	8.7	10.4	9.4
Median	13.6	9.8	10.9	9.2
Tuition discount rate (%)				
Mean	27.8	15.7	14.8	11.0
Median	27.8	17.0	16.4	11.2
Instruction (%)				
Mean	27.8	42.9	50.1	51.0
Median	28.0	36.3	57.4	48.1
	Endowment			
Endowment market value ($ mil.)				
Mean	607,825	173,048	56,952	13,701
Median	438,201	185,088	45,310	12,622
	Liquidity ratios			
Cash and investments to operations (%)				
Mean	1063.1	627.6	240.5	123.3
Median	1029.9	600.2	212.1	118.3
Unrestricted resources to operations (%)				
Mean	297.1	366.5	160.9	70.8
Median	253.8	283.7	132.3	63.2
Expendable resources to operations (%)				
Mean	800.4	473.0	201.7	86.0
Median	763.6	409.4	182.6	74.5
Cash and investments to debt (%)				
Mean	1763.0	695.5	355.3	241.8
Median	1190.2	685.6	305.1	189.5
Unrestricted resources to debt (%)				
Mean	420.0	405.8	212.0	122.5

Table 1

U.S. Independent Schools Financial Statistics For 2007* (cont.)				
Median	327.0	342.2	168.1	89.1
Expendable resources to debt (%)				
Mean	1303.7	523.5	279.8	160.5
Median	932.2	498.3	219.1	113.7
	Debt ratios			
Total outstanding debt (mil. $)				
Mean	41,903	27,812	19,893	15,154
Median	40,000	30,684	19,151	8,553
Current debt service burden (%)				
Mean	4.4	6.0	5.7	5.8
Median	3.5	5.7	5.6	5.1
Average age of plant (years)				
Mean	10.3	11.0	11.1	9.1
Median	10.2	10.4	10.3	9.5
	Full-time equivalent ratios			
Net tuition per headcount ($)				
Mean	26,384	22,936	20,094	19,312
Median	26,594	24,087	20,071	19,509
Adjusted operating revenue per headcount ($)				
Mean	77,120	70,458	38,503	27,566
Median	77,479	62,441	35,507	26,036
Total operating expenses per headcount ($)				
Mean	65,810	53,485	30,146	23,390
Median	65,932	52,606	28,431	21,780
Debt per headcount ($)				
Mean	58,938	62,292	33,042	19,919
Median	62,510	59,815	33,226	17,108
Unrestricted resources per headcount ($)				
Mean	225,319	263,944	61,659	17,451
Median	189,671	170,940	45,732	13,717
Expendable resources per headcount ($)				
Mean	607,744	323,830	74,037	21,610
Median	570,552	181,348	65,518	18,866
Endowment market value per headcount ($)				
Mean	768,358	401,970	98,874	20,807
Median	743,012	356,718	88,573	18,699

*Most recent data available at the time of publication.

Table 2

Independent School Ratings by Rating Category*

Institution	State	Rating	Outlook
AAA			
Deerfield Academy	MA	AAA	Stable
Hotchkiss School	CT	AAA	Stable
Phillips Academy Andover	MA	AAA	Stable
Phillips Exeter Academy	NH	AAA	Stable
St. Paul's School	NH	AAA	Stable
AA			
Groton School	MA	AA+	Stable
Peddie School	NJ	AA+	Stable
Western Pennsylvania School for Blind Children	PA	AA+	Stable
Albuquerque Academy	NM	AA	Stable
The Hockaday School	TX	AA	Stable
St. Andrew's School of Delaware	DE	AA	Positive
St. Johns School	TX	AA	Stable
St. Mark's School	TX	AA	Stable
Taft School	CT	AA	Stable
Emma Willard School	NY	AA-	Stable
Hopkins School	CT	AA-	Stable
Milton Academy	MA	AA-	Stable
Thacher School	CA	AA-	Stable
A			
John Burroughs School	MO	A+	Stable
Nightingale-Bamford School	NY	A+ (SPUR)	Stable
Belmont Hill School	MA	A	Stable
Dexter and Southfield Schools	MA	A (ICR)	Stable
Germantown Friends School	PA	A	Stable
Kent School	CT	A (ICR)	Stable
Westminster School	CT	A (SPUR)	Stable
Westtown School	PA	A (SPUR)	Stable
Collegiate School	VA	A-	Positive
Creighton Preparatory School	NE	A-	Stable
Germantown Academy	PA	A-	Stable
The Haverford School	PA	A- (SPUR)	Stable
Holland Hall School	OK	A-	Stable
Norwich Free Academy	CT	A- (SPUR)	Positive
Pomfret School	CT	A- (ICR)	Stable
Salisbury School	CT	A-	Stable
Thayer Academy	MA	A-	Stable
BBB			
St. John's High School of Worcester County	MA	BBB+	Stable

Table 2

Independent School Ratings by Rating Category* (cont.)			
Suffield Academy	CT	BBB+ (SPUR)	Stable
Berwick Academy	ME	BBB	Stable
Bullis School	MD	BBB (SPUR)	Stable
Crossroads School	CA	BBB	Stable
Gonzaga College High School	DC	BBB (SPUR)	Stable
Lycee Francais de New York	NY	BBB	Stable
Packer Collegiate Institute	NY	BBB (SPUR)	Stable
The Rumson Country Day School	NJ	BBB	Stable
Viewpoint School	CA	BBB (SPUR)	Stable
Waynflete School	ME	BBB	Stable
Wheeler School	RI	BBB	Stable
Denver Academy	CO	BBB-	Stable
Green Acres School	MD	BBB-	Stable
Marymount School of New York	NY	BBB- (SPUR)	Positive
McLean School	MD	BBB-	Stable
New Hampton School	NH	BBB-	Stable
BB			
Cambridge Friends School	MA	BB+	Stable
Evergreen Country Day School	CO	BB	Stable

ICR--Issuer credit rating. SPUR--Standard & Poor's underlying rating. *As of Sept. 30, 2008.

Qualitative factors

Standard & Poor's also considers a number of qualitative factors that might affect our rating considerably, including strength and depth of an institution's senior management team and governing board. Furthermore, while we don't track fundraising data in our ratio table, we look for strong annual fund performance. In particular, a high parent- and alumni-participation rate as well as history of successful comprehensive capital campaigns could enhance a credit rating. In addition, we evaluate an institution's operating performance based on generally accepted accounting principles (GAAP), and a history of positive operating performance is a key factor in our credit ratings (see table 3).

Table 3

Independent School Ratings By State*

Institution	State	Rating	Outlook
Crossroads School	CA	BBB	Stable
Thacher School	CA	AA-	Stable
Viewpoint School	CA	BBB (SPUR)	Stable
Denver Academy	CO	BBB-	Stable
Evergreen Country Day School	CO	BB	Stable
Hopkins School	CT	AA-	Stable
Hotchkiss School	CT	AAA	Stable
Kent School	CT	A (ICR)	Stable
Norwich Free Academy	CT	A- (SPUR)	Positive
Pomfret School	CT	A- (ICR)	Stable
Salisbury School	CT	A-	Stable

Table 3

Independent School Ratings By State* (cont.)			
Suffield Academy	CT	BBB+ (SPUR)	Stable
Taft School	CT	AA	Stable
Westminster School	CT	A (SPUR)	Stable
Gonzaga College High School	DC	BBB (SPUR)	Stable
St. Andrew's School of Delaware	DE	AA	Positive
Belmont Hill School	MA	A	Stable
Cambridge Friends School	MA	BB+	Stable
Deerfield Academy	MA	AAA	Stable
Dexter and Southfield Schools	MA	A (ICR)	Stable
Groton School	MA	AA+	Stable
Milton Academy	MA	AA-	Stable
Phillips Andover Academy	MA	AAA	Stable
St. John's High School of Worcester County	MA	BBB+	Stable
Thayer Academy	MA	A-	Stable
Bullis School	MD	BBB (SPUR)	Stable
Green Acres School	MD	BBB-	Stable
McLean School	MD	BBB-	Stable
Berwick Academy	ME	BBB	Stable
Waynflete School	ME	BBB	Stable
John Burroughs School	MO	A+	Stable
Creighton Preparatory School	NE	A-	Stable
New Hampton School	NH	BBB-	Stable
Phillips Exeter Academy	NH	AAA	Stable
St. Paul's School	NH	AAA	Stable
Peddie School	NJ	AA+	Stable
The Rumson Country Day School	NJ	BBB	Stable
Albuquerque Academy	NM	AA	Stable
Emma Willard School	NY	AA-	Stable
Lycee Francais de New York	NY	BBB	Stable
Marymount School of New York	NY	BBB- (SPUR)	Positive
Nightingale-Bamford School	NY	A+ (SPUR)	Stable
Packer Collegiate Institute	NY	BBB (SPUR)	Stable
Holland Hall School	OK	A-	Stable
Germantown Academy	PA	A-	Stable
Germantown Friends School	PA	A	Stable
The Haverford School	PA	A- (SPUR)	Stable
Western Pennsylvania School for Blind Children	PA	AA+	Stable
Westtown School	PA	A (SPUR)	Stable
Wheeler School	RI	BBB	Stable
St. Johns School	TX	AA	Stable
St. Mark's School	TX	AA	Stable
The Hockaday School	TX	AA	Stable

Table 3

Independent School Ratings By State* (cont.)			
Collegiate School	VA	A-	Positive

ICR--Issuer credit rating. SPUR--Standard & Poor's underlying rating. *As of Sept. 30, 2008.

'AAA' Category Profile

Demand

The universe of 'AAA' rated private schools, many of which were among the first independent schools ever rated by Standard & Poor's, consists of fairly large, highly selective institutions, with long operating histories. As a result, the competitive position of these private schools within the entire independent school market is in our view extremely strong. Highly rated private schools have an expansive geographic draw, which consequently pushes their enrollment levels among the highest within the universe of rated independent schools.

For fall 2006, enrollment levels averaged 773 students for the 'AAA' category. These schools have the ability to house a larger percentage of their students on campus than do lower-rated schools. As such, we believe these institutions are better equipped to market programs and attract students from outside their home state and often, the country. Therefore, in our view, unfavorable local economic trends or demographics are less likely to hinder enrollment levels.

Because of what we consider the strong national academic reputations of most 'AAA' rated schools, admission standards have been highly selective. Applications continue to be, in our view, strong due to a wide geographic draw and strong reputation worldwide. Acceptance rates for fall 2006 averaged 20%--well below the rates reported by 'BBB' rated entities. When coupled with average matriculation rates of approximately 66%, 'AAA' private schools have significant admissions flexibility.

Moreover, we believe these schools' strong demand profiles and very generous financial aid packages result in the admission of students with exceptional academic quality. Graduating seniors at 'AAA' rated schools generally boast SAT scores well above the national average, with most students subsequently enrolling in the country's most selective colleges and universities.

Finances

Independent schools rated in the 'AAA' category typically exhibit what we consider significant operating flexibility because of highly diversified funding sources. While lower-rated institutions often rely heavily on tuition and student fees to fund their operating budgets, most 'AAA' rated schools have, in our view, considerable revenue diversity afforded by private giving and sizable endowment draws. Tuition and related fees, on average, accounted for just 47% of the 'AAA' category's unrestricted revenues during fiscal 2007. Moreover, 'AAA' private schools have historically demonstrated what we consider very strong fiscal management by producing surpluses every year and using a spending draw that schools have recently reduced to less than 5% of the endowment market value.

Standard & Poor's traditional measures of liquidity, including cash and investments and unrestricted resources—as well as expendable resources for schools located in Massachusetts and Pennsylvania--are very strong in the 'AAA' category of independent schools. For fiscal 2007, the 'AAA' rated institutions, on average, reported cash and investment balances equal to 10x adjusted operating expenses. Unrestricted and expendable resources equaled 2.9x and 8x, respectively.

'AAA' rated institutions all benefit from what we consider sizable endowment funds, which have consistently appreciated due to historically aggressive fundraising efforts and very strong investment performance. Endowment market value for the 'AAA' category averaged roughly $608 million in fiscal 2007, compared with just $14 million at the 'BBB' rated institutions. We believe the financial cushion provided by these large endowments has enabled these institutions to better weather any variability in enrollment level as well as economic downturn, which could hamper fundraising efforts.

Fundraising

'AAA' level independent schools historically have been among the most aggressive fundraising entities in the sector, drawing significant financial support from a large alumni pool and active parent base. We believe the prestige of these institutions, coupled with strong connections that many of these schools maintain with faculty, pupils, and alumni, all motivate constituents to make sizable contributions to both the annual fund and other institutional development efforts. Participation rates tend to be in our view extremely high, reflecting parent and student satisfaction with their former institutions.

Capital campaigns at 'AAA' rated schools tend to be much larger and more comprehensive than those typically initiated by the 'BBB' rated institutions. Furthermore, campaign goals tend to be exceeded with a significant percentage of the contribution coming from very active board members. One recent trend has been the large focus on endowment-related fundraising for financial aid and faculty salary increases.

Debt

All of the 'AAA' rated independent schools have what we consider substantial financial resources and therefore have strong debt capacity. The average absolute amount of leverage outstanding is higher than what we commonly witness at the lower end of the private schools rating universe. For fiscal 2007, long-term debt averaged about $42 million, compared with just $15 million at the 'BBB' level. In addition, since many of the highly rated institutions have sizable operating budgets, carrying charges typically average in our view a very low 4.4% of expenditures.

'BBB' Category Profile

Demand

More than 31% of rated private independent schools fall into the 'BBB' category. Schools in this category tend to exhibit considerably different operating characteristics from those in the 'AAA' category. Headcount enrollment, for example, averaged 696 students for 'BBB' rated private schools compared with 773 students for 'AAA' level schools. Furthermore, most 'BBB' rated schools tend to be day schools. Additionally, because of their relatively smaller size, we believe many 'BBB' level schools are more susceptible to even slight fluctuations in headcount compared with their 'AAA' rated counterparts, pressuring them to accept a larger number of applicants each year.

In fall 2006, the need to fill seats was demonstrated by what we consider to be a fairly high average acceptance rate of 61%, which also reflects limited competition since most 'BBB' rated institutions tend to be located in areas with little public or private competition. The new student matriculation rate averaged 65% for this category in fall 2006. Moreover, these private schools tend to attract most of their students from the surrounding community, often placing the schools at the mercy of local unfavorable economic trends and demographics.

Finances

The average 'BBB' rated private school is heavily reliant on tuition and student fees to fund its annual budget. For fiscal 2006, tuition accounted for approximately 79% of adjusted operating revenues in this category. Contribution and endowment draw is much lower than 'AAA' category schools and therefore, in our view, makes a 'BBB' rated institution more financially vulnerable to declining enrollment. We believe the financial operations of a typical independent school in this category includes strong dependence on tuition and auxiliary income, mostly break-even operating performance on a GAAP basis, and a manageable tuition discount rate of roughly 11%.

Liquidity balances are, in our view, much weaker in this category compared with the 'AAA' category, with the average for cash and investments, unrestricted resources, and expendable resources compared with adjusted operating expenses equal to 123%, 71%, and 86%, respectively.

Typically, 'institution endowment levels in this category are also much smaller than higher rated schools, with an average endowment market value for fiscal 2007 of $14 million. On average, 'BBB' rated schools tend to have much younger operating histories and therefore have had very limited fundraising initiatives than older, and often more highly rated, credits. In addition, a younger operating history results in much lower growth in endowment with investment returns.

Fundraising

Largely correlated to endowment size, the level of fundraising activity at 'BBB' level independent schools has been limited. However, as many of these relatively young institutions continue to graduate classes of increasing size, we expect a growing cadre of satisfied parents and proud alumni can and will be targeted for continuing support. The level of giving is much lower in size and participation than higher rated institutions, but as the schools mature, we tend to see an improvement in the level of gift giving for both the annual fund as well as capital gifts.

Debt

In most cases, a limited financial cushion impedes lower-rated schools from adding significant leverage to their books. Consequently, mean outstanding debt for 'BBB' category private schools tends to be what we consider low, averaging $15 million in fiscal 2007. However, due to the relatively small operating budgets of many of these schools, even small amounts of debt are magnified as a percentage of total expenses. For fiscal 2007, the debt burden of 'BBB' rated independent schools averaged 5.8%. Furthermore, expendable resources-to-debt ratios are also lower for 'BBB' rated private schools, with a mean of 161% in fiscal 2007.

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