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Related Research

- [Revenue-Supported Rating Criteria, Aug. 16, 2010](#)

Summary

This report represents a sector-specific extension to Fitch Ratings' global "Revenue-Supported Rating Criteria" report (dated Aug. 16 and available on its Web site at www.fitchratings.com) and provides elaboration and interpretation of operating and financial profile rating considerations for independent schools. It identifies factors considered by Fitch in assigning ratings to a particular entity or debt instrument within the scope of the criteria. Not all rating factors outlined in this report may apply to each individual rating or rating action. Each specific rating action commentary or rating report will discuss those factors most relevant to the individual rating action.

An independent school is defined by Fitch as a not-for-profit, private elementary, and/or secondary institution serving kindergarten through 12th grade. Unlike their public counterparts, including both traditional district schools and charter schools, an independent school receives little to no tax support. Rather, tuition and other enrollment-related fees and, to a lesser extent, annual contributions generally serve as the primary sources of funding. Independent schools may be nonsectarian or have an affiliation with a religious order that may or may not provide meaningful ongoing financial support. Schools classified as day schools serve the academic needs of their student body during a traditional school day. Boarding schools complement classroom learning with a residential life component similar to the college and university market.

In assessing the credit quality of an independent school, Fitch will focus on several core factors as follows:

- **Operational Effectiveness:** including an institution's ability to effectively manage its enrollment base and position itself vis-à-vis competitors within the market.
- **Demand Flexibility:** particularly as it relates to an institution's ability to achieve enrollment goals without sacrificing student quality and/or tuition and fee revenue.
- **Fund Raising:** which can help an institution diversify its funding base away from student-related revenue sources.
- **Operating Performance:** including an institution's sources of budgetary support and ability to prudently manage expenditures in line with revenues to ensure stable margins over time.
- **Balance Sheet Resources and Liquidity:** notably the degree to which such balances protect an institution from unexpected interruptions in core revenues and/or unexpected, significant increases in costs.
- **Debt Burden:** with a primary focus on an institution's ability to service annual carrying charges from current operations.

Operating Profile

For the vast majority of independent schools (institutions or schools), their ability to meet financial obligations hinges on student demand for program offerings. While institutions vary in terms of type (primary or secondary) and delivery model (day or boarding), the vast majority of revenues collected by schools are either generated directly by enrollment (tuition and fees) or indirectly influenced by it (contribution and

gift income). Consequently, to assess the effectiveness of an institution's business strategy, Fitch reviews an independent school's service area demographic and socioeconomic attributes; historical enrollment patterns; marketing and pricing strategies; and admissions process.

Attributes

Stronger Attributes	Demonstrated enrollment stability over a full business cycle, fueled by highly effective competitive strategies; pipeline of prospective students for successive incoming classes is robust.
Midrange Attributes	Enrollment trends, while generally stable, are prone to some fluctuation during weaker economic climates; competitive strategies effective at maintaining stable demand over time.
Weaker Attributes	Volatile trends in student headcount; well articulated vision and mission are lacking; less effective competitive strategies enabling competitors to cherry pick prospective students.

Enrollment stability, rather than institutional size, correlates strongly with investment-grade ratings, as most primary and secondary schools are relatively small, especially compared with their peers in higher education.

Although tuition and fee revenues and fund raising are key credit drivers for most independent schools, investment income for some institutions also plays an important role. In most years, a sizable endowment and/or pool of long-term financial assets provide higher levels of investment income. The receipt of such income generally enables a school to reduce reliance on student-generated revenue sources and annual contributions, which could be variable.

Operational Effectiveness

Enrollment and Market Position

To gauge overall trends in enrollment, Fitch reviews five years of data measured by both headcount and full-time equivalent students (FTEs). Given the small size of most independent schools (generally less than 500 students), significant enrollment swings or declines could have a negative impact on a school's financial viability. Generally speaking, stable to upward trending enrollment (1%–3%) is viewed favorably; a one-year decrease or increase is not considered a trend but should be explained by the school's management. Significant, sustained declines in enrollment could be a credit concern, particularly if the gain or loss of students is unexpected, has a material adverse financial impact, and, from a budgetary perspective, cannot be managed.

Key factors influencing enrollment patterns include the school's mission and location; the demographic and socioeconomic characteristics of the service area; competition, primarily with public schools and other private schools; and the school's reputation and/or market niche. Given that day schools are more likely to draw students from their immediate service area, the more favorable the prevailing demographic and economic trends, the more likely it is that a school will successfully meet its headcount target. Private day schools are, in most cases, the more expensive alternative to traditional public schools or charter schools. Consequently, the affluence of the local population, assessed through various economic indicators, such as median household income, is an important consideration.

Attributes

Stronger Attributes	Regional draw for students within an affluent market area; any competitive threats are generally muted by a track record of highly favorable academic performance indicators, which also create considerable tuition-pricing flexibility.
Midrange Attributes	Generally stable local market serves as primary feeder for the school; academic performance indicators are generally in line or slightly ahead of those of competitors; more limited tuition-pricing flexibility, particularly when local economic conditions deteriorate.
Weaker Attributes	Highly concentrated, local draw in a demographically and economically challenged service area; academic performance indicators may be equal to or below those of the competition; extremely limited pricing flexibility.

Specialty schools, including those catering to students with unique interests and needs, and boarding institutions generally have a wider regional draw than traditional day schools. In general, these schools are better equipped to handle an economic downturn in their local market, as students are drawn from a broader geographic area. As part of its analysis, Fitch will focus on the mission of a specialty or boarding institution, along with the strategic plan to maintain or strengthen its market position vis-à-vis local or regional competitors. The vitality of feeder systems and/or referral networks for these schools is also examined. In assessing the credit quality of a Catholic school, for example, Fitch would review trends in a local market's Catholic population, along with the penetration rate for parochial schools in the area. For a specialty high school, Fitch would consider overall demand for the primary school or network of primary schools that feed the specialty secondary school, along with trends in the absolute number of students.

Demand Flexibility

Admissions

The trend in the number of students applying to an independent school is an indicator of student demand. While a sustained decline in applications would raise concern, particularly if such decline was not intended, Fitch does not necessarily view increasing application levels as reflective of strengthening demand for a particular institution. Given the increased use and ease of online application filing and, in most cases, the lack of an associated application fee, the expectation for most schools is stable to growing application levels over time. Management would be expected to explain the reasons for stagnation or significant and persistent declines in application levels.

To provide context for application trends and better assess overall student demand, Fitch discusses with a school's admissions staff its recruitment efforts, the pool of schools to which applicants apply as alternatives, and expected changes in the competitive landscape. During this discussion, major strategic shifts in recruitment strategies or market positioning should be disclosed.

Acceptance rates demonstrate a school's ability to control future enrollment. Institutions that accept 75% or more of applications generally have less flexibility if the private primary or secondary school suffers a decline in applications. For certain targeted specialty schools (e.g. theater and music), higher acceptance rates do not necessarily signify a weaker market position, as this type of institution tends to attract a self-selecting population of students who will likely gain admission.

Matriculation rates, also known as student yield rates, and defined as the number of accepted students who chose to enroll, divided by the total number of accepted students, are indicative of a school's relative position among its competitors. Generally speaking, the higher an institution's matriculation rate, the more likely it is an institution of first choice for many of its applicants.

Attributes

- Stronger Attributes** Consistently high matriculation rates, indicative of the school’s first-choice status among prospective students, and highly competitive admissions process, which provides a school considerable flexibility to shape the profile of incoming classes.
- Midrange Attributes** Stable matriculation rates, which may be high or low, depending on market dynamics; admissions process is somewhat competitive, although acceptance rates tend to be fairly high, limiting enrollment flexibility.
- Weaker Attributes** Variable matriculation rates, which are usually low; non-competitive admissions process, with generally no ability to shape the profile of an incoming class; heavy tuition discounting to attract students is often a necessity.

Comparative matriculation rates are most informative when used to contrast institutions serving a similar student population and teaching the same curriculum. Comparisons among independent schools serving different needs or markets are not appropriate. For example, a highly selective New England boarding school should not be compared with a primary or secondary school serving special needs students. If data are available for peer group schools, trends in matriculation among “cross-admits,” or students accepted to more than one institution, can denote a school’s level of success enrolling the students it desires.

Indicators of Student Demand

Indicators	Use of Indicators in the Rating Process
Number of Applicants	Stable to growing numbers reflect continued interest in the school.
Acceptance Rate	In general, the higher the acceptance rate, the less flexibility the school has to increase future enrollment. However, for schools offering unique, targeted programs, higher acceptance rates are more common, as only qualified students apply.
Matriculation Rate	The higher the matriculation rate, the greater the likelihood that the school is the student’s first choice.
Standardized Achievement Scores	Varies; scores are considered in conjunction with the mission of the school.
Retention Rates	Higher rates reflect student satisfaction.
Graduation Rates	High rates reflect success providing desired program offerings.
Reputation of/Publicity for School	A history of a positive reputation is desired. Recent negative publicity can have an adverse effect on enrollment and future fund raising.

Student Quality Indicators

Typical measures used to reflect scholastic aptitude, or student quality, include grade-point average and student achievement on standardized assessment and graduation placement exams. Other indicators include the percentage of students enrolled in and successfully completing honors and/or advanced-placement courses, retention and graduation rates, and, for most secondary schools, the college-going rate of the graduating senior class.

In general, independent schools with strong student quality indicators are in a better position to adjust admission levels during a period of declining applications without materially affecting enrollment. If a school’s student quality indicators are favorable, compared with those of its competitors, there is room to relax admission standards while maintaining strong quality. As part of its analysis, Fitch will compare an independent school’s quality indicators with those of its closest competitors. For most day schools, Fitch reviews test scores and other metrics achieved by students attending nearby traditional district schools and/or charter schools. For specialty and boarding schools, the peer group is further expanded to include institutions serving a similar population or having a comparable academic focus.

Attributes

- Stronger Attributes** Consistent track record of superior student academic outcomes that enhances demand and pricing flexibility and better positions a school to solicit contributions from parents and alumni.
- Midrange Attributes** Academic outcomes tend to be in line with or better than those of the competition, with parental expectations generally met or exceeded; a moderate degree of admissions and pricing flexibility influenced by trends in student achievement, which could fluctuate from time to time.
- Weaker Attributes** Academic performance of the school tends to lag that of the market; failure to consistently meet parental expectations negatively impacts recruiting, retention, and the ability to fund raise.

Pricing Strategy

Given that competition with one or more tax-supported, tuition-free public school or charter school nearly always exists, tuition levels are a significant consideration for parents opting to send their child to a private primary or secondary institution. Tuition competitiveness is most effectively measured through a comparison of tuition and fees among peer institutions. Tuition trends for an individual school are also analyzed on a net basis. Net tuition revenue is defined as gross tuition and fees, net of internally funded student aid. This information can be used to determine the extent to which an independent school is successfully passing along higher costs to students once the impact of tuition discounting (total scholarship and financial aid, divided by gross tuition) is considered.

Attributes

- Stronger Attributes** Consistent, annual growth in net tuition revenue supported by stable tuition discounting policies; internal resources are readily available to meet the institutionally funded financial aid budget.
- Midrange Attributes** Stable to slightly upward trending growth in net tuition revenue; tuition discounting policies, while generally stable, more likely to move in response to market dynamics; institutional resources could be pressured if an increase in financial aid levels is warranted.
- Weaker Attributes** Net tuition revenue is stagnant to in decline; discounting of tuition is often significant in an attempt to attract students from competitors; institutional resources are generally insufficient to meet any increase in the financial aid budget.

Campus Life

While the cost of an independent school education weighs heavily in the decision making process for most parents, other factors do come into play. In addition to academic reputation and student quality discussed earlier, the aesthetic appearance of a school's campus, the availability and competitiveness of athletic programs, and, for boarding schools, the availability of quality student housing are important considerations. As part of its analysis, Fitch discusses with management the short- and long-term strategic plans for these components of campus life, including plans to address major deferred maintenance items. Additionally, Fitch reviews the history of annual spending for buildings and maintenance and assesses the feasibility of the school's longer term master plan for facilities. Management's discipline in budgeting for and allocating resources to support ongoing physical plant investment is viewed favorably in the rating process.

Fund Raising

Institutional development, commonly referred to as fund raising, provides an important resource for many independent schools. With the exception of only a few well-endowed institutions that benefit from significant annual investment income, proceeds of annual

giving are generally an independent school's second most significant source of operating revenue, after tuition and other student fees.

Contributions to a primary or secondary school come from a variety of sources, including alumni, parents, foundations, and corporations. However, for most independent schools, alumni and parents tend to be the dominant donors. In general, gifts and contributions are made to a school either on an unrestricted basis or are restricted to a specific purpose or initiative. While a fund-raising culture takes time to develop, many institutions initially focus on increasing annual fund participation among alumni and parent groups, later building off this base to launch comprehensive capital campaigns, which generally target a host of institutional priorities. In assessing a private primary or secondary school's fund-raising prowess, Fitch reviews the track record of development activities in the context of institutional mission, operating environment, and established fund-raising culture.

Attributes

Stronger Attributes	Long-standing, fund-raising culture, supported by mature, well-developed infrastructure to effectively solicit donor contributions; annual giving tends to be robust, punctuated periodically by comprehensive capital campaigns.
Midrange Attributes	Established fund-raising culture, supported by basic infrastructure needed to solicit donor contributions; annual fund giving tends to dominate, with only a few, narrowly focussed campaigns to support specific initiatives.
Weaker Attributes	Lackluster fund-raising culture, highlighted by a spotty track record of development activities; generally no infrastructure in place to support effective fund raising, with most donations solicited on an ad-hoc basis.

Generally speaking, there is a strong correlation between ratings and an independent school's ability to fund raise, particularly when proceeds of a capital campaign are designated for endowment or will help provide budgetary support for scholarship and financial aid.

Financial Profile

Financial metrics contribute significantly to rating determinations. With inputs derived from audited financial statements and other supporting financial documents, Fitch calculates and evaluates quantitative assessments of revenue diversity, operating performance, balance sheet resources, and debt burden, as well as the historical trends of such measures. Expectations for future financial performance and, ultimately, the credit rating, are informed by assessments of those factors. As long as a borrower's underlying strategic position remains sound, a certain amount of variability in financial performance should not affect the rating on the bonds.

Statement of Activities

Fitch analyzes both the revenue and expense sections of the statement of activities to determine concentration of revenues and flexibility of expenses. Significant changes in revenues or expenses from one year to another should be explained by management. The ability to generate excess revenues over expenditures on an annual basis is essential for maintaining or improving a school's long-term financial position and providing adequate debt service coverage.

Operating Performance

Revenue Diversity

Fitch recognizes that, for most private primary and secondary institutions, the ability to materially diversify away from student-generated revenue sources, which generally

represent approximately 75% of total operating revenues, is limited. This fact underscores the importance of enrollment management and highlights the need for an effective tuition pricing strategy and related financial aid policies. For some institutions, concentration in tuition and other student-related fees is muted by robust, annual giving, and/or investment income. While these streams are uncorrelated with student demand and the most likely source of diversification for an independent school, they have their own associated risks (e.g. volatility), which are considered in the rating process.

Operating Margin

The operating margin measures a school’s ability to generate revenue from its core operations sufficient to meet annual expenditures, fund routine maintenance, and service financial obligations. While Fitch recognizes margins may vary from year to year, over a five-year period, the expectation is for at least a break-even level of performance. By generating a consistent margin at or above a break-even level, a private primary or secondary school is less reliant on its unrestricted reserves for operating support and can generally service debt from its annually available surplus.

Select Operating Performance Metrics

Diversity of Revenues	Concentration in any one revenue source could be a concern but may be mitigated by a history of stability.
Volatility of Revenue	A revenue source that contributes at least 10% of revenues is reviewed for changes that have affected its consistency.
Operating Margin	Operating surplus divided by total unrestricted operating revenues.

Note: Both revenues and expenses are reviewed over several years, usually five, to determine the consistency of the school’s financial operating performance.

In computing the operating margin for an independent school, two major adjustments are made by Fitch to determine total unrestricted operating revenues. The first adjustment involves the reclassification of “net assets released from restrictions for capital purposes” from operating revenues to non-operating revenues since such amounts cannot be used to fund expenditures. Depending on audit presentation, this level of detail may or may not be discernible from the financial statements but may be obtained through a conversation with management.

The second adjustment involves the reclassification of realized and unrealized investment gains and losses from operating to non-operating revenues. This reclassification, which primarily impacts primary and secondary schools with significant endowment or long-term investment holdings, eliminates the impact of large market-value swings, both positive and negative, providing greater consistency from one credit to the next. Depending on their magnitude, market-value swings could have a significant impact on reported revenues, although they are generally outside a school’s control and not reflective of how its finances are being managed. For example, unrestricted operating revenues may be improving in all categories for the year, but a significant market value loss at year end could result in a decline in unrestricted net assets for that year.

Select Measures of Liquidity and Leverage

Available Funds	Includes cash and investments that are not permanently restricted. Available funds provide a measure of balance sheet resources.
Adjusted Available Funds	Includes cash and investments that are not permanently restricted. Also excludes financial assets deemed as alternative investments per the audited financial statements.
Debt Service Coverage	Measures a school’s ability to service debt from annual surplus.
Debt Burden	Measures pro forma MADS as a percentage of total unrestricted operating revenues. Fitch considers a debt burden equal to or greater than 10% as high.

MADS – Maximum annual debt service.

Most independent schools with significant financial resources include in their annual budget an amount they expect will be distributed from total investment returns, including dividends and interest and accumulated gains and losses, to support operations. This amount, commonly referred to as an endowment payout, is formulaically determined under a spending policy, which is generally board approved. Most spending policies are based on a lagged, 12-quarter moving-average market value, with annual payouts ranging from 4.5%–6.0%. A variance from this range is not necessarily viewed negatively by Fitch but will trigger further discussions.

Given that the exclusion of all gains and losses, per the adjustment described above, will result in a negative operating margin for most institutions annually receiving an endowment payout, Fitch will generally calculate two operating margins to better gauge operating performance. The first calculation of operating margin will include a school's gross investment income, primarily dividends and interest, with no recognition of any accumulated gains. Under the second calculation, Fitch will include dividends and interest, as well as the portion of accumulated gains recognized under the spending policy as endowment payout, but only if such amount can be obtained from the financial statements.

For institutions that budget for a portion of expenses to be supported by investment returns, Fitch views the operating margin inclusive of the full spending policy payout as a better indicator of financial health. As long as the return on long-term investments exceeds distributions made under the spending policy, reliance on the payout alone is not, in and of itself, a negative credit factor. However, the greater a primary or secondary school's reliance on the payout, the less flexibility it maintains to ratchet back spending under the policy during times of prolonged financial market turbulence.

Balance Sheet Resources and Liquidity

In analyzing an independent school's resource base, Fitch examines the magnitude of financial assets and the liquidity of these holdings. In general, the size of an institution's resource base correlates strongly with its ability to consistently generate an operating surplus and its track record of fund raising.

For institutions with sizable investment holdings, the largest component of the portfolio is generally assets held in perpetuity. These funds, which are intended to benefit the school over the long term, include endowment funds and other funds that function similarly to endowment assets, although with fewer restrictions as to use. In addition to long-term investments, well-endowed private primary and secondary institutions may also maintain sizable short- and intermediate-term cash and investment pools to support short-term working capital needs and variable-rate demand programs. Generally speaking, these investments tend to be highly liquid and available on-demand, with minimal notice.

To gauge the magnitude of an independent school's resource base, Fitch calculates available funds, or an institution's total cash and investments not permanently restricted. This balance is then compared with expenditures and leverage as measures of financial flexibility. As part of its analysis of balance sheet resources, Fitch reviews investment performance from the close of the most recent audited fiscal year and considers the potential impact that financial market movements may or may not have had on metrics derived from those audited financial statements.

Fitch acknowledges that most well-endowed independent schools continue to invest sizable shares of their long-term investment portfolios in alternative asset classes, including hedge funds and private equity. While these investments, which are almost always held with a long-term horizon, provide the opportunity for enhanced returns, they are generally illiquid, not immediately accessible, and sometimes require additional commitment of capital. In addition, their valuation is derived from a

subjective assessment of an investment manager or managers, not an objective, transparent financial market, and reported on a lagged basis.

Given these characteristics of alternative assets, which in some cases comprise greater than 50% of a school's total investments, and recognizing that because of these holdings available funds no longer provide a sufficient proxy for liquid resources, Fitch will calculate an adjusted available funds metric that attempts to distil the core available funds calculation discussed above into its most liquid, most accessible components. In the adjusted calculation, Fitch typically includes traditional equity and fixed-income investments, as well as U.S. government-backed securities, mutual funds, and cash. Hedge funds, private equity, and real estate are the most common alternative investments stripped out of the adjusted metric.

While for some institutions adjusted available funds suggest a much weaker level of financial flexibility than the traditional available funds computation, Fitch recognizes that this calculation is conservative, as it gives no credit to holdings, which, while not immediately available, will likely have a value at the end of their investment horizon. Moreover, these investments are rarely intended as a source of near-term liquidity or working capital. For these reasons, Fitch will continue to reference both available funds and adjusted available funds in its credit analysis.

Fitch does not associate a target asset allocation with a particular rating level. However, an institution's investment policy will be evaluated in the context of its overall financial position and financial management practices, including level of internal reporting controls. For private primary or secondary schools with significant revenue concentration, stagnant demand trends, and erratic operating performance, the liquidity of balance sheet holdings becomes more important, as this type of school will be more reliant on liquid reserves for annual operating support. Fluctuation in available fund balances, or overexposure to less liquid alternatives, would, thus, be viewed negatively. On the other hand, institutions with more stable operating and financial characteristics have a greater capacity to withstand temporary fluctuations in available fund balances. These institutions are also better equipped to handle the illiquidity risks associated with a heavy exposure to nonmarketable securities, given their consistent ability to cover annual expenditures and meet financial obligations from operations.

Attributes

Stronger Attributes	Track record of positive operating performance, supported by a diverse revenue base, and solid resource levels; exposure to nonmarketable, illiquid securities tempered by operating strengths and availability of other, more liquid funds.
Midrange Attributes	Break-even to generally positive operating performance, supported by stable, enrollment-related revenues, and adequate to healthy resource levels; modest exposure to nonmarketable securities, with a more limited ability to manage the illiquidity issues accompanying these investments.
Weaker Attributes	Generally negative operating performance, supported by variable, enrollment-related revenues, and adequate to fairly weak resource levels; extremely limited financial capacity to manage the risks associated with any exposure to nonmarketable asset classes.

Debt Burden

When assessing leverage, Fitch reviews the existing level of debt, the debt structure, and future plans for debt issuance. For this reason, Fitch prefers to see that a private primary or secondary school has a capital improvement plan with a documented process for assessing capital projects, a time horizon for completion, and anticipated sources of funding. Typically, capital plans cover a period of at least five years and are subject to periodic review.

To assess an independent school's ability to manage its financial obligations, Fitch calculates a debt burden and will review historical and projected debt service coverage levels. The debt burden, calculated by Fitch as the ratio of pro forma maximum annual debt service (MADS) as a percentage of unrestricted operating revenues, indicates the portion of current-year unrestricted operating revenues required to meet the maximum amount of annual principal and interest on outstanding and proposed new-money bonds through final maturity. In addition to carrying charges on long-term debt instruments, pro forma MADS also includes debt service on notes payable, capital leases, and non-cancellable operating leases. While Fitch generally considers a debt burden at or above 10% as significant, other factors, most notably consistently strong coverage of debt service (discussed below), may help to mitigate at least a portion of the risks associated with a significant debt burden.

Debt service coverage is measured by comparing net income available for debt service with both historical carrying charges and projected maximum annual principal and interest payments. In calculating annual net income available for debt service (net available income), Fitch begins with the change in unrestricted net assets from operations (excluding realized and unrealized gains and losses) and adds back noncash items, such as depreciation, and interest expensed during the year. The stronger the coverage of debt service provided by net available income, the greater the likelihood that the school will make timely debt service payments and not rely on unencumbered reserves to meet minimum coverage thresholds.

Peer Comparisons

With few exceptions, independent schools report demand and financial data in a standardized manner. While this standardization enables a meaningful comparison of key credit variables among institutions and helps facilitate the assignment of a bond rating, other intangible, qualitative variables, such as the strength of management, play an integral role.

For all private primary and secondary schools rated by Fitch, individual metrics are compared with the median values exhibited at the recommended rating level, as well as with individual institutions at that rating level possessing similar operating and/or financial attributes. In marginal situations, Fitch will expand the universe of comparable institutions, including median values for independent schools above or below the recommended rating to further support the rating rationale and highlight contrasts.

Importantly, Fitch notes that the ranges over which demand and financial metrics vary can be broad and overlap among rating categories for certain metrics. Moreover, ratings are forward looking and imply an expectation of the future rather than what previously occurred. Nevertheless, improvement or deterioration in a private primary or secondary school's demand and/or financial metrics is an important rating driver, with improvement or deterioration in such variables relative to medians and peers a potential source of positive or negative rating pressure.

Financial Metrics

Financial results correlate reasonably well with credit ratings. The table on page 11 displays definitions of select measures used by Fitch to evaluate and compare independent schools.

Median financial ratios will vary over time because bond ratings allow for a certain amount of performance variability and cyclicalities, and no absolute floors or ceilings are prescribed for individual metrics to qualify for a particular rating level. Strong performance in one metric may or may not compensate for poor performance in another, depending on the metrics involved and other circumstances of the borrower. Also, qualitative factors and expectations for future performance often result in ratings for borrowers that may have one or several metrics that diverge from published medians.

Typical Independent School Credit Factors by Rating Category

	AAA/AA	A	BBB	Non-Investment Grade
Operational Effectiveness	Stable or growing headcount; dominant market position; often the school of first choice for the grade levels served or specialty focus (e.g. fine arts or theater).	Stable or growing headcount; sound market position; while often not a school of first choice, academic program offerings are well regarded.	Generally stable headcount, although subject to increasing volatility; admissions process is somewhat competitive, although the school is rarely a first choice; average academic reputation.	Headcount subject to significant volatility; admissions process is lackluster, with competitive strategies often reactionary; school is never a first choice, and, in most cases, attracts students on affordability versus quality of academics.
Demand Flexibility	Superior; low acceptance rates (generally below 30%) and high matriculation rates (generally above 40%); tuition discounting is extremely manageable (generally below 30%).	Sound; moderately low acceptance rates (generally 50%–60%) and moderately high matriculation rates (generally 30%–40%); tuition discounting is manageable (generally 30%–35%).	Adequate; moderately high acceptance rates (generally 60%–75%) and moderately low matriculation rates (generally 20%–30%); tuition discounting is increasingly burdensome (generally 35% to potentially as high as 40%).	Limited to extremely limited; high acceptance rates (generally 75% or higher) and low matriculation rates (at most 25%, but generally lower); tuition discounting is likely burdensome (generally 40% or higher).
Fund Raising	Superior; established fund-raising culture and infrastructure for solicitation of robust annual fund and capital campaign donations; extremely loyal donor base, which is generally less susceptible to the cyclicity of the economy.	Sound; established fund-raising culture, albeit more recent than ‘AA’/‘AAA’ rating categories; infrastructure is in place to support robust annual giving, although history of capital campaign activity is limited; loyal donor base, although level of giving is susceptible to the cyclicity of the economy.	Adequate; fund-raising culture is not well established, nor is there infrastructure in place to support predictable levels of annual giving, although periodic gifts are received; most donations are received by the school on an ad-hoc basis in support of specific capital projects.	Limited to extremely limited; generally no fund-raising culture and no infrastructure in place to support predictable levels of annual giving; donor activity is isolated to a few examples of fund raising for building improvements, equipment, and supplies.
Operating Performance	Generally sustained track record of positive operating margins, particularly when the school’s investment return generated by its substantial resource base is fully recognized through endowment payout.	Generally sustained track record of positive operating margins, both with and without recognition of endowment payout; the school typically has lower resource levels than its ‘AAA’ and ‘AA’ category counterparts, which generate a correspondingly lower level of investment return.	Generally sustained track record of break-even to positive operating margins; endowment payout is typically immaterial to operating performance given that resource levels generating an investment return are minimal.	Generally sustained track record of negative operating margins; school benefits from little, if any, investment return, as resource levels are extremely minimal.
Balance Sheet Resources and Liquidity	Superior; available funds provide a significant financial cushion (generally 3.0x and greater) relative to both financial leverage and operating expenditures; illiquidity of certain long-term investments is generally offset by short-term or intermediate-term liquid assets.	Sound; available funds provide a solid financial cushion (generally 1.1x–3.0x) relative to both financial leverage and operating expenditures; illiquidity of certain long-term investments may or may not be offset by short-term or intermediate-term liquid assets, which could be viewed negatively; illiquid assets tend to be a much lower percentage of total investments at the ‘A’ and ‘A-’ rating levels.	Adequate; available funds provide a reasonable financial cushion (generally 0.4x–1.1x) relative to both financial leverage and operating expenditures; schools in the ‘BBB’ rating category tend to have little or no exposure to illiquid investments.	Limited to extremely limited; available funds provide only a minimal financial cushion (generally less than 0.4x) relative to both financial leverage and operating expenditures; schools in the ‘BB’ rating category generally have no exposure to illiquid investments.
Debt Burden	Moderately low (3%–6%); most schools with a higher debt burden tend to offset the magnitude of the burden with strong (generally 1.4x and greater) coverage of pro forma debt service from net available income.	Moderate to moderately high (5%–8%); some schools with a higher debt burden tend to offset the magnitude of the burden with sound (1.3x–1.5x) coverage of pro forma debt service from net available income.	Moderately high to high (6%–10%); some schools with a higher debt burden tend to offset the magnitude of the burden with consistent (1.0x–1.3x) coverage of pro forma debt service from net available income.	High (10% and greater); most schools do not have an ability to mitigate the magnitude of the burden with coverage of pro forma debt service at or above 1.0x from net available income; reliance on unencumbered reserves to meet 1.0x coverage is viewed negatively at this rating level, given the limited nature of the financial cushion.

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