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Baltimore County, Maryland Garrison Forest School; Independent Schools

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Credit Profile		
US$6.5 mil fixed rate rev rfdg bnds (Garrison Forest School) ser 2017 due 06/01/2042		
Long Term Rating	A-/Stable	New
Baltimore Cnty, Maryland		
Garrison Forest School, Maryland		
Series 2006 A.B,C,D		
Long Term Rating	A-/Stable	Affirmed

Rationale

S&P Global Ratings assigned its 'A-' long-term rating to Maryland Industrial Development Financing Authority's $6.6 million series 2017 fixed-rate revenue bonds issued for Garrison Forest School. The outlook is stable.

The rating reflects our view of the school's robust financial resources, surplus operations on a cash basis in most years, good fund raising history, and low debt burden with no expected additional debt forthcoming over the next two years. Although the school's declining enrollment is a credit concern, the school has managed to maintain a relatively stable level of net tuition revenue.

In our view, the school has been well governed and managed; however, a leadership transition is currently underway involving recruitment for a new permanent head of school while an interim head of school has been selected for the upcoming school year and a new chief financial officer (CFO) is expected to be hired shortly. We believe the declining enrollment trend will likely lead to continued small, full-accrual-based operating deficits for the current and following year; however, a generally favorable trend for boarding student enrollment with boarders paying almost double the cost of attendance compared with day students should enable the school to maintain its relatively stable net tuition revenue.

The rating is further supported by the school's:

- Adequate financial performance for the rating with cash based surpluses recorded in all recent years except for fiscal 2016, which was basically a break-even year;
- Growing financial resources with expendable resources increasing 84% to $17.1 million in fiscal 2016 from a recent low of $9.3 million in fiscal 2012 and an endowment that has averaged about $37.2 million over the past five years and was $35.4 million at fiscal year-end 2016;
- Modest debt of $6.6 million after the refunding that represents just 8.3% of the school's total asset base of $79.6 million, and a low pro forma maximum annual debt service (MADS) burden of 2.3% of fiscal 2016 adjusted operating expenses; and
- Sound governance and management with multiple board committees that include enrollment and marketing, finance, investments, buildings and grounds, school life, strategic initiatives, and development.

In our view, the following credit factors are placing downward pressure on the rating:

- A decrease of 7.0% in the total student headcount to 572 students for fall 2016 compared to the prior year's headcount enrollment of 615 students;
- Continued tuition sensitivity due to strong competition;
- A long-range strategic plan that lacks specific financial operating goals that we view as desirable and a best practice; and
- A high average age of plant of 19.5 years that suggests that deferred maintenance needs could be building and potentially requiring additional debt issuance.

The independent school, founded in 1910, serves students from age three through 12th grade and is located about 18 miles north-west of Baltimore, in Owings Mills, on a 110 acre campus. The campus includes 28 buildings built between the late 1800s and 2008, contributing to the high average age of plant.

Garrison Forest School offers coeducational programs for three-year-olds and prekindergarten, with kindergarten through 12th-grade education for girls. Management notes that about 20% of the upper-school's students board on campus and there is flexibility if students want to board only for a semester or less. The school's niches include a science program with Johns Hopkins University and its equestrian facilities and program that include a polo team.

We understand the purpose of the fixed-rate series 2017 bonds is to currently refund the school's series 2006 subseries A, B, and D issues that were structured as multiannual mode variable-rate bonds. A fourth subseries of the 2006 bonds subseries C were completely paid off by the school in advance on Oct. 1, 2016. The series 2017 bonds will eliminate the school's exposure to interest rate risk and the bonds are being structured to eliminate principal payments until 2023 and have a final maturity in fiscal year 2043. The latter final maturity extends by 10 years the final maturity of the series 2006 bonds. While ordinarily we do not view favorably maturity extensions in refunding issues, and in this case also deferral of principal amortization for five years, we recognize that this financial structure was designed to provide the school some financial flexibility as it moves through a transition in leadership and repositions itself in its market with the expectation that its enrollment will stabilize within the next few years.

The series 2017 bonds are secured by the school's revenue pledge. The school also has $409,193 outstanding on a line of credit as of fiscal year end 2016.

Outlook

The stable outlook reflects our expectation that over the next two years enrollment may decline slightly, financial performance will be positive on a cash basis and improve on a full accrual basis while financial resource ratios will remain sufficient to support the rating with no expectation of additional debt.

Downside scenario

While not expected during the next two years, we could consider a negative rating action if the school's financial resources deteriorate unexpectedly or if its operating performance on a full accrual basis declines substantially rather than showing some modest improvement as expected. Also, if enrollment declines accelerate, rather than diminish as expected, or if additional debt pressures financial resource ratios a lower rating could result.

Upside scenario

A positive rating action is viewed as unlikely over the next two years but might be considered if enrollment and financial performance strengthens leading to stronger financial resource ratios while debt declines some from its present level.

Enterprise Profile

Enrollment

Enrollment at Garrison Forest decreased again in fall 2016, falling 7.0% to 572 students from 615 in the prior year. This represents the second year of declining enrollment after enrollment stabilized in fall 2014. We believe the enrollment pressure relates more to the relative competiveness of the region with a number of well-established independent schools also competing for students. Management notes that prior enrollment declines were largely centered in its prekindergarten and lower-school levels.

Selectivity worsened in fall 2016 with an acceptance rate of 85%, rising from 60% in the prior year and 71% for the prior three year period. The matriculation trend over the same three-year period has weakened, falling to 56.5% in fall 2016 from 63.5% in fall 2013. Management reports that demand for the upper school and boarding program is strong. For fall 2016, enrollment was 44 students in the preschool program, 129 in the lower school, 136 in the middle school, 263 in the upper school, including 74 boarding students. Preliminary estimates for fall 2017, enrollment are more than 40 in the preschool program, 114 in the lower school, 126 in the middle school, and 274 in the upper school, including 71 boarding students.

Major entry points are sixth grade and ninth grade. In years past the retention rate typically exceeded 90%, which we consider strong. Graduates go on to a variety of colleges and universities, including the University of Maryland, the University of Virginia, Clemson University, Syracuse University, and Dickinson College.

Management

The school is governed by a 32-member board of trustees. In April, the board retained the services of Lila Boyce Lohr (a Garrison Forest alum from the class of 1963) to be Interim Head of School for the 2017-2018 year after the current Head announced she would be leaving the position at semester's end. A national search will be conducted for a new permanent Head of School. Ms. Lohr was the Head of School for St. Paul's School for Girls in Baltimore and has served as interim Head of School for Friend School of Baltimore and most recently, Towne School for Boys in San Francisco. Also, Garrison Forest's current CFO is leaving at the end of the current school year and a replacement is expected to be named very shortly. Other than these changes in management the school has had relatively stable governance and management. Although management does not budget for depreciation, it does provide for debt service and plant reserves. We consider this a good practice as it comes close to general accepted accounting principle (GAAP)-based budgeting.

Financial Profile

Operations

Operating performance is variable and negative in most years on a full accrual GAAP basis, but consistently positive on a cash basis, though fiscal 2016 saw just about breakeven results on a cash basis. In fiscal 2016, Garrison posted an operating deficit of $1.37 million after posting lower deficits of $174,000 and $446,000 in fiscal years 2015 and 2014, respectively. We adjust operating results for unrealized investment gains and losses, and exclude transfers. With $1.33 million in annual depreciation expense in recent years preceding fiscal 2016 cash based results would be considered healthy. On a budgetary basis, deficits of approximately $950,000 and $1.24 million are planned for fiscal years 2017 and 2018, respectively. Management indicates it expects full accrual based performance for fiscal 2017 may resemble the performance experienced in fiscal 2016.

Garrison, like many of its peers, is tuition dependent with tuition and auxiliary fees accounting for 85.7% of fiscal 2016 adjusted operating revenue. Net tuition and fee income declined 3.7% in fiscal 2016, compared to a 3.6% increase in fiscal 2015, to $13.3 million in fiscal 2016 from $13.9 million in 2015. Tuition in fall 2016 was $28,790 for day upper-school students and $55,640 for traditional boarding students, representing an approximate 3.5% and 5.9% increase, respectively, from the previous year.

The tuition discount rate has gradually increased to 22.6% in fiscal 2016 from 19.6% in fiscal 2015 and from 17.1% in fiscal 2010, signifying the competitiveness of the market for students. The school expects enrollment for fall 2017 total approximately 545 students, which would represent a 5.4% decline from the fall 2016 enrollment.

Financial resources

We consider financial resources adequate for the rating category totaling $17.0 million at fiscal year-end 2016. The level of financial resources on hand at fiscal year-end 2016 equates to 71.4% of adjusted operating expenses, trailing the 139.9% median for the rating category, and 257% of pro forma debt exceeding the 185.2% median for the rating category. Cash and investments are much stronger in our view at $46.1 million at fiscal year-end 2016 equating to 193.0% of expenses and 694.7% of pro forma debt and are much closer to the 213.3% median for cash and investments to expenses and exceeding substantially the 293.3% median for cash and investments to debt for the rating category.

The school's endowment decreased 5.3% to $35.4 million at fiscal year-end 2016 from the $37.4 million recorded at the end of 2015. The asset allocation of the school's investment portfolio as of April 17, 2017, consisted of 59% equities, 23% alternative assets, and 19% fixed income. The 2016 audit classified the assets between level one (99%) and level three (0.5%), which is rather liquid, in our opinion. However, the vast majority (87%) of the endowment is permanently restricted. The endowment draw for operating support is 4% of a three-year rolling average of the endowment market value with an additional 1% authorized in recent years for plant expenditures; the total draw for fiscal 2016 was $1.8 million.

Fundraising

The school completed its capital campaign in 2012, launched in 2004, meeting its goal of $25 million. About $2.8 million in pledges are still outstanding. The school completed a $22 million campaign in 1999. Annual giving for capital and endowment over the past three years has averaged $1.6 million each year.

Garrison Forest School, Maryland Financial Statistics

	--Fiscal year ended June 30--					Medians for 'A' rated independent schools
	2017	2016	2015	2014	2013	2015
Enrollment and demand						
Headcount	572	615	630	627	651	MNR
New student selectivity (%)	84.6	60.4	67.9	72.7	72.7	39.0
New student matriculation (%)	56.5	57.3	72.1	63.5	62.0	66.0
Boarding HC to total HC (%)	12.9	11.4	12.4	11.2	10.6	MNR
Tuition increase year over year (%)	5.1	4.8	3.2	4.6	4.8	MNR
Income statement						
Adjusted operating revenue ($000s)	N.A.	22,516	22,882	22,206	21,867	MNR
Adjusted operating expense ($000s)	N.A.	23,884	23,056	22,652	22,078	MNR
Net operating income ($000s)	N.A.	(1,368)	(174)	(446)	(211)	MNR
Net operating margin (%)	N.A.	-5.73	-0.75	-1.97	-0.96	MNR
Tuition dependence (%)	N.A.	76.6	75.4	74.5	74.8	73.0
Tuition discount (%)	N.A.	22.6	19.6	19.2	18.9	19.7
Student dependence (%)	N.A.	85.7	85.3	84.8	84.4	MNR
Change in unrestricted net assets ($000s)	N.A.	(1,395)	(184)	(372)	(52)	MNR
Debt						
Outstanding debt ($000s)	N.A.	9,354	9,409	9,590	9,601	33,645
Proposed debt ($000s)	N.A.	6,635	N.A.	N.A.	N.A.	MNR
Total pro forma debt ($000s)	N.A.	6,635	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	547	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	1.13	0.94	1.07	1.10	4.80
Current MADS burden (%)	N.A.	2.68	3.57	3.63	3.71	MNR
Pro forma MADS burden (%)	N.A.	2.29	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value ($000s)	N.A.	35,364	40,011	41,362	36,240	68,448
Cash and investments ($000s)	N.A.	46,092	48,390	49,718	42,624	MNR
Unrestricted net assets ($000s)	N.A.	17,957	19,352	19,536	19,908	MNR
Expendable resources ($000s)	N.A.	17,052	17,425	18,581	12,255	MNR
Cash and investments to operations (%)	N.A.	193.0	209.9	219.5	193.1	213.3
Cash and investments to debt (%)	N.A.	492.8	514.3	518.4	444.0	293.3
Cash and investments to pro forma debt (%)	N.A.	694.7	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	71.4	75.6	82.0	55.5	139.9
Expendable resources to debt (%)	N.A.	182.3	185.2	193.8	127.6	185.2
Expendable resources to pro forma debt (%)	N.A.	257.0	N.A.	N.A.	N.A.	MNR

Garrison Forest School, Maryland Financial Statistics (cont.)

	--Fiscal year ended June 30--					Medians for 'A' rated independent schools
	2017	**2016**	**2015**	**2014**	**2013**	**2015**
Average age of plant (years)	N.A.	19.5	18.7	18.2	17.6	11.8

N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service. Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100*(net adjusted operating income/adjusted operating expense). Tuition dependence = 100*(gross tuition revenue/adjusted operating revenue). Current debt service burden = 100*(current debt service expense/adjusted operating expenses). Current MADS burden = 100*(maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short-term & long-term investments Expendable resources = unrestricted net assets + temp. restricted net assets - (net PPE- outstanding debt). Average age of plant = accumulated depreciation/depreciation and amortization expense.