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Ratings

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Middlebury College, Vermont Vermont Education And Health Building Financing Agency; Private Coll/Univ - General Obligation

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Vermont Ed & Hlth Bldg Fin Agy (Middlebury College)		
Long Term Rating	AA/Stable	Affirmed

Rating Action

- S&P Global Ratings affirmed its 'AA' long-term rating on Vermont Education & Health Building Financing Agency's outstanding bonds, issued for Middlebury College (Middlebury).
- The outlook is stable.

Security

As of June 30, 2022, Middlebury had approximately $310.1 million in debt outstanding. Upon including a refunding and a new money debt issuance that was directly placed in August 2022, the college's debt increased to $326.9 million (described as pro forma debt in our analysis). This includes $171.2 million in public debt outstanding, $106.8 million in directly placed debt, $46.2 million in a capital lease, and $2.7 million in operating leases. The college entered into a new capital lease agreement for a housing facility in Monterey, Calif., for its graduate students in fiscal 2022. All outstanding debt is fixed rate and a general obligation of Middlebury. Maximum annual debt service (MADS; smoothed for a bullet payment in fiscal 2047) was manageable, in our view, at $18.7 million, equal to 4.9% of fiscal 2022 operating expenses. We understand that the college may issue a small amount of additional debt in the near term. While we will evaluate the full effect of this on the college's credit profile when details become available, at this time, preliminary plans do not indicate a material weakening of its ratios.

Credit overview

We assessed Middlebury's enterprise profile as extremely strong, with excellent demand and student quality, a broad geographic recruitment reach, multiple campuses, diverse programs, and fundraising success. We assessed Middlebury's financial profile as strong, with a sizable endowment and an average debt burden consistent with the rating category. These strengths are somewhat offset by the trend of operating deficits on a full-accrual basis, although we understand that the management team continues to focus on improving operating results in the near term. We believe that these credit factors, combined, lead to an indicative stand-alone credit profile of 'aa-'. In our opinion, the 'AA' rating on the college's bonds better reflects Middlebury's significant cash and investments compared to outstanding debt.

The 'AA' rating reflects our assessment of Middlebury's:

- Sizable endowment, with a balance of $1.47 billion as of June 30, 2022;
- Solid reputation with excellent student demand and quality;
- Fundraising success, with contributions running strong for a current campaign in the planning phase; and
- Programmatic diversity, with a liberal arts college in Vermont, niche foreign language programs in the U.S. and abroad, and graduate programs in Monterey, Calif.;

In our opinion, offsetting credit factors include the college's:

- Trend of full-accrual operating deficits, although we understand that this is partly driven by its need-blind admissions policy; and
- Acceleration risk associated with its direct placement debt portfolio, although we view the risk as manageable compared to the college's liquidity levels.

Environment, social, and governance

We analyzed the college's environmental, social, and governance credit factors pertaining to its market position, management and governance, and financial performance. Health and safety risks, which we consider a social risk factor, have largely abated and are neutral in our credit rating analysis. All other environmental and governance credit factors are also neutral in our credit rating analysis.

Outlook

The stable outlook reflects our expectation that Middlebury will sustain its solid demand position, preserve its operating performance, and maintain the strength of its balance sheet. While the college may note some enrollment declines at the undergraduate level in the near term, we understand this is a strategic decision and not a reflection of fundamental demand.

Downside scenario

We could consider a negative rating action if operating performance weakens and results in larger operating deficits, if available resources decline materially, or if the college issues significant additional debt without commensurate growth in available resources.

Upside scenario

We could consider a positive rating action if Middlebury reports full-accrual surpluses on a consistent basis and improves available resource ratios to a level comparable to higher-rated peer institutions while maintaining its demand position.

Credit Opinion

Enterprise Profile

Market position and demand

Middlebury College, founded in 1800, is in Middlebury, Vt. It enrolled 2,756 undergraduate students on a full-time equivalent (FTE) basis in fall 2022 and is primarily a residential undergraduate liberal arts college. The campus consists of approximately 350 acres and more than 160 buildings. The Middlebury Institute of International Studies (MIIS) at Monterey enrolls about 582 graduate students, and Middlebury's summer programs, including the foreign language programs and the Bread Loaf School of English, enroll about 1,500 students annually, while the Middlebury C.V. Starr Schools abroad enroll about 650 students annually. In addition to its traditional undergraduate academic year program, the institution operates several popular summer-session programs at its main campus in Middlebury, Vt.; the Bread Loaf Campus in Ripton, Vt.; and other sites both domestically and abroad. Middlebury's niches are the foreign language programs, environmental studies, and a liberal arts curriculum.

Middlebury has an excellent demand profile, with a broad geographic draw (only 4% of the students came from Vermont in fall 2022), highly selective admissions, robust matriculation, and overall stable enrollment, especially at the undergraduate level. Enrollment at the college noted some fluctuation during the pandemic, with a larger class enrolling in fall 2021 due to a large number of deferrals from fall 2020 (which had a higher acceptance rate as a precautionary measure at the start of the pandemic), pent-up demand, and Vermont's successful controls during the pandemic. Middlebury reported an enrollment decline in fall 2022 as management works to bring down the undergraduate enrollment to right-size the enrollment. We understand that the college expects to bring the undergraduate enrollment closer to the 2,600 student-level, compared to 2,756 undergraduate students enrolled in fall 2022.

Middlebury competes with other top-tier liberal arts schools in the U.S.; its primary competitors are Amherst College, Bowdoin College, Carleton College, Pomona College, and Williams College, according to management. Given the national competition for the same high-quality students Middlebury strives to enroll, we consider the 39% matriculation rate for fall 2022 robust. Student retention matches that of the leading schools in the U.S., with what we consider a strong freshman-to-sophomore retention rate of 95%. The college has a need-blind admissions policy and enrolls about 50% of its freshman class through the early-decision process. Middlebury reported a decline in the graduate enrollment to 582 students on an FTE basis in fall 2022 from 640 students in fall 2021. We understand that management views this decline to be temporary, and expects a rebound, especially with its new housing lease in Monterey.

Management and governance

Middlebury's president, Dr. Laurie Patton, joined the organization in 2015 following a national search. Apart from the appointment of a new vice president of diversity, equity, and inclusion and an interim provost, the president's cabinet has remained stable during the past year. We view the management's depth and expertise as solid, with experience leading top tier higher educational institutions across the country. We do not expect significant changes to the senior management team or the board in the near term.

Middlebury rolled out its new comprehensive strategic plan in January 2018. During the past few years, Middlebury also followed an operating plan aimed at enhancing revenues and holding expenses to achieve GAAP operating surpluses. While management showed progress toward this goal and initially expected to achieve breakeven operations by fiscal 2021, the timeline was delayed due to the additional expenses and revenue shortfall associated with the pandemic. Management expects that the college is likely a few years away from achieving this goal.

Financial Profile

Financial performance

Middlebury has reported a decade-long trend of posting operating deficits. Although this trend continued in the past year, we view the reduction in the size of the deficit positively: It improved to $4.6 million (negative 1.2% margin) in fiscal 2022 from $12.0 million (negative 3.6% margin) in fiscal 2021. We also consider management's focus on reducing the endowment draw positively, with fiscal 2022 being the first year since 2015 without an incremental draw. The effective spending rate was 3.8% in fiscal 2022, compared to 4.9% in the previous year, and much higher draw rates a decade ago. Fiscal 2022 results were supported by $4.1 million in the institutional portion of federal relief funds associated with the pandemic, with less than $1 million remaining to be spent in fiscal 2023. As a result, we understand that the operating deficit is expected to be slightly larger in 2023, although still smaller than in past years. We continue to view the college's operating performance as weaker than most peer institutions, although we consider its expectation to move closer to breakeven levels in the near term a positive.

As Middlebury maintains a need-blind admissions policy, its discount rate varies based on student need. The fiscal 2022 tuition discount rate was 41.4%, comparable to the 40.9% in fiscal 2021. The rate is overstated compared to certain peer institutions, though, as it includes the total scholarships provided by the college against just the net tuition revenues (according to management), and not the full comprehensive fee revenue. We consider Middlebury's tuition discount rate as manageable despite its need-blind admission policy. For fall 2022, comprehensive fees totaled $80,260, a 4.5% increase from $76,820 charged in fall 2021. Middlebury's revenue diversity is typical for an undergraduate liberal arts college of its caliber; student revenue generated 69.3% of fiscal 2022 total revenue while investment and endowment income accounted for 15.3% of revenue.

Available resources

Following a steep increase in fiscal 2021 due to exceptional market performance, available resources weakened slightly in fiscal 2022. Expendable resources of $983.3 million represented 260% of adjusted operating expenses and 301% of pro forma debt, adequate for the rating category. Cash and investments (a less conservative measure due to restricted endowment) were stronger at $1.5 billion, or 399% of operations and 462% of pro forma debt.

Middlebury uses an outside investment manager (Investure LLC) to serve as the external investment office. As of Dec. 31, 2022, the $1.425 billion endowment comprised 20.5% in public equity, 21.0% in venture funds, 19.7% in private equity, 14.8% in hedge funds, 10.2% in real assets, and the remaining assets comprised credit, fixed income, non-marketable assets and cash. Unfunded commitments to private partnerships were approximately $289 million, which we consider relatively high but still manageable at 20% of total investments as on Dec. 31, 2022.

Middlebury has a strong history of fundraising and an active alumni base; we consider these credit strengths. The college exceeded its goal in a $500 million comprehensive capital campaign that ended in 2015, having raised about

$535 million. The alumni participation rate continues to be quite strong, in our view, at about 33% in 2022, although it declined from 53% in 2015. Management reports that the college is in the planning phase of a new comprehensive campaign to be launched in the near term.

Debt and contingent liabilities

Middlebury currently has three outstanding series of directly placed debt (series 2016, series 2021 and series 2022), totaling an approximate balance of $106.8 million on a pro forma basis. We have reviewed the associated loan agreements and believe there are cross-default provisions associated with the debt. However, we view the likelihood of triggering default to be remote. In addition, given approximately $191 million in the college's investments were liquid daily as of January 31, 2023, we believe there is sufficient coverage to address this contingent liability.

Middlebury College, Vt.: Enterprise And Financial Statistics

	--Fiscal year ended June 30--					Medians for 'AA' rated Private Colleges & Universities
	2023	**2022**	**2021**	**2020**	**2019**	**2021**
Enrollment and demand						
Headcount	3,422	3,553	3,273	3,277	3,264	9,643
Full-time equivalent	3,338	3,443	3,195	3,220	3,195	8,501
Freshman acceptance rate (%)	12.6	13.5	22.0	15.4	16.7	20.6
Freshman matriculation rate (%)	38.9	42.5	29.8	40.4	40.7	36.0
Undergraduates as a % of total enrollment (%)	81.0	80.4	78.8	78.7	79.0	68.5
Freshman retention (%)	95.0	95.0	95.0	94.0	96.0	92.3
Graduation rates (six years) (%)	94.0	91.0	93.0	93.0	91.0	91.5
Income statement						
Adjusted operating revenue ($000s)	N.A.	373,569	321,157	339,941	348,751	MNR
Adjusted operating expense ($000s)	N.A.	378,120	333,118	351,587	359,952	MNR
Net operating income ($000s)	N.A.	(4,551)	(11,961)	(11,646)	(11,201)	MNR
Net operating margin (%)	N.A.	(1.20)	(3.59)	(3.31)	(3.11)	2.40
Change in unrestricted net assets ($000s)	N.A.	(16,251)	45,088	(26,413)	(26,218)	MNR
Tuition discount (%)	N.A.	41.4	40.9	38.2	38.3	40.0
Tuition dependence (%)	N.A.	56.5	56.3	57.2	55.7	50.9
Student dependence (%)	N.A.	69.3	66.8	68.2	68.6	58.4
Endowment and investment income dependence (%)	N.A.	15.3	18.5	17.0	16.4	11.1
Debt						
Outstanding debt ($000s)	N.A.	310,137	265,505	246,385	259,940	534,327
Proposed debt ($000s)	N.A.	61,290	N.A.	N.A.	N.A.	MNR
Total pro forma debt ($000s)	N.A.	326,917	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	5.23	4.52	4.40	4.45	MNR
MADS burden (%)	N.A.	4.94	4.45	4.19	4.76	5.20

Middlebury College, Vt.: Enterprise And Financial Statistics (cont.)

	--Fiscal year ended June 30--					Medians for 'AA' rated Private Colleges & Universities
	2023	2022	2021	2020	2019	2021
Financial resource ratios						
Endowment market value ($000s)	N.A.	1,467,208	1,511,001	1,133,644	1,157,786	2,559,082
Cash and investments ($000s)	N.A.	1,510,252	1,555,453	1,151,370	1,189,236	MNR
Unrestricted net assets ($000s)	N.A.	204,601	220,852	175,764	202,177	MNR
Expendable resources ($000s)	N.A.	983,280	1,047,305	663,475	719,073	MNR
Cash and investments to operations (%)	N.A.	399.4	466.9	327.5	330.4	466.9
Cash and investments to debt (%)	N.A.	487.0	585.8	467.3	457.5	540.7
Cash and investments to pro forma debt (%)	N.A.	462.0	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	260.0	314.4	188.7	199.8	313.1
Expendable resources to debt (%)	N.A.	317.0	394.5	269.3	276.6	407.9
Expendable resources to pro forma debt (%)	N.A.	300.8	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	23.1	22.7	23.6	21.6	14.2

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). Student dependence = 100*(gross tuition revenue + auxiliary 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 and 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.

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022