School Rating Criteria

Sector-Specific Criteria

This report describes the operating and financial factors India Ratings and Research (Ind-Ra) considers in rating independent schools (schools, or institutions). Not all rating factors outlined in this report may apply to an individual rating or rating action. Each specific rating action commentary or rating report will discuss those factors most relevant to the individual rating action.

This report represents a sector-specific extension to Ind-Ra criteria report "Revenue Supported Rating Criteria," dated 11 September 2015.

Private, Tuition Supported Institutions: Institutions covered by this sector-specific criteria report are not-for-profit, private elementary, and/or secondary institutions serving kindergarten through 12th grade (K-12). Unlike their public counterparts, an independent school receives little to no government support. Rather, tuition and other enrolment-related fees and, to a lesser extent, annual contributions generally serve as the primary sources of funding.

Various School Types and Models: Schools may have an affiliation with a religious group that may or may not provide meaningful on-going 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.

Enrolment Dependent: For the vast majority of institutions, 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 enrolment (tuition and fees) or indirectly influenced by it (contribution and gift income).

Size Does Not Necessarily Matter: Enrolment stability, rather than institutional size, correlates strongly with higher ratings, as most primary and secondary schools are relatively small, especially compared with their peers in higher education. However, the smaller a school's enrolment base, the more susceptible is its financial profile to the loss of only a few students.

Investment Income for Wealthy Schools: 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.

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Methodology

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

Operational Effectiveness

Enrolment-driven revenues are the primary source of operating funds for most institutions. Consequently, a school's ability to effectively manage its enrolment base and position itself vis-à-vis competitors is critical to maintaining or improving its financial position.

Demand Flexibility

Institutions capable of achieving enrolment goals without sacrificing student quality tend to be less susceptible to changes in demand and related revenues.

Fundraising

Demonstrated fundraising prowess may enable a school to reduce reliance on student-generated funding streams and fund investments in scholarships, programs, and infrastructure.

Revenue Diversity and Operating Performance

A lower level of revenue concentration suggests an unexpected interruption in funding from one source will not impact a school's ability to prudently manage expenditures in line with revenues.

Balance Sheet Resources and Liquidity

Schools with a sizable financial cushion are better protected from an unexpected, material decline in core revenues and/or unexpected significant increase in costs.

Debt Burden

The ability of a school to consistently generate strong debt service coverage may help offset a high debt burden; debt burden is calculated as maximum annual debt service (MADS) as a percentage of current unrestricted operating revenues.

Operating Profile

Tuition and fee revenues and, to a lesser degree, fundraising are key credit drivers for most independent schools. Consequently, to assess the effectiveness of a school's business strategy, Ind-Ra reviews an independent school's service area demographic and socioeconomic attributes; historical enrolment patterns; marketing and pricing strategies; and admissions process.

Operational Effectiveness

Institutional Attributes and Operating Environment Affect Enrolment Profile

To gauge overall trends in enrolment, Ind-Ra reviews five years of data measured by both headcount and the total student strength. Given the small size of most independent schools, significant enrolment swings or declines could have a negative impact on a school's financial viability. Generally, stable to upward trending enrolment is viewed favourably; a one year decrease or increase is not considered a trend but should be explained by the school's management. Significant, sustained declines in enrolment 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 enrolment 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 favourable the prevailing demographic and economic trends, the more likely it is that a school will successfully meet its headcount target. Private day schools (international and global) are, in most cases, the more expensive alternative to traditional public schools.

Related Research

Revenue Supported Rating Criteria, 11 September 2015

Consequently, the affluence of the local population, assessed through various economic indicators such as median household income, is an important consideration. Ind-Ra believes K-12 schools except international and global schools do not have a significant demand impact from an economic slowdown.

Niche or Focus Important to Assessing Demand

Figure 1
Attributes: Enrolment

Stronger attributes	Demonstrated enrolment stability over a full business cycle, fuelled by highly effective competitive strategies; pipeline of prospective students is robust.
Midrange attributes	Enrolment trends, while generally stable, are prone to some fluctuation due to quality; competitive strategies effective at maintaining stable demand over time.
Weaker attributes	Volatile trends in student headcount; well-articulated vision and mission lacking; less effective competitive strategies enabling competitors to cherry pick prospective students.

Source: Ind-Ra

Comparative enrolment 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 old boarding school (such as Doon, Welham and Mayo) and newly started global/international schools should not be compared with a primary or secondary school serving special needs students. If data are available for peer group schools, trends in enrolment among so-called cross-admits, or students accepted to more than one institution can denote a school's level of success enrolling the students it desires.

As part of its analysis, Ind-Ra 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. For a specialty high school, Ind-Ra 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.

Figure 2
Attributes: Demand

Stronger attributes	National or regional draw for students within an affluent market area; any competitive threats are generally muted by a track record of highly favourable academic performance indicators, which also create considerable tuition pricing flexibility.
Midrange attributes	Generally stable local market serves as a primary feeder for the school; academic performance indicators are generally in line or slightly ahead of those 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 or below those of competition; extremely limited pricing flexibility.

Source: Ind-Ra

Demand Flexibility

Application Trends

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, Ind-Ra does not necessarily view increasing application levels as reflective of strengthening demand for a particular institution. Management would be expected to explain the reasons for stagnation or significant and persistent declines in application levels.

Metrics Evaluated in Context

Acceptance rates demonstrate a school's ability to control future enrolment. 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, 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.

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

Figure 3
Attributes: Admissions

Stronger attributes	Consistently high enrolment 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 enrolment 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 enrolment flexibility.
Weaker attributes	Variable enrolment 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.

Source: Ind-Ra

Comparisons among independent schools serving different needs or markets are not appropriate. For example, a highly selective old boarding school (such as Doon, Welham and Mayo) should not be compared with a primary or secondary school serving special needs students. If data are available for peer group schools, trends in enrolment among so-called cross-admits, or students accepted to more than one institution can denote a school's level of success enrolling the students it desires.

Strong Student Quality Provides Flexibility

Typical measures used to reflect student quality, include passing percentage and student achievement in board examination. Other indicators include the percentage of students enrolled in reputed technical courses (in IITs, NITs and reputed medical colleges) for secondary school with science and in reputed colleges for humanities, science and commerce courses.

Figure 4
Indicators of Student Demand

Indicators	Use of indicators in the rating process
Number of applicants	Stable to growing numbers reflect continued interest in the institution.
Acceptance rate	In general, the higher the acceptance rate, the less flexibility the institution has to increase future enrolment. However, for schools offering unique, targeted programs, higher acceptance rates are more common, as only qualified students apply.
Enrolment rate	The higher the enrolment rate, the greater the likelihood that the institution is the student's first choice.
Board examination result	Vary; scores are considered in conjunction with the mission of the institution.
Retention rates	Higher rates reflect student satisfaction.
Passing 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 enrolment and future fundraising.

Source: Ind-Ra

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 enrolment. If a school's student quality indicators are favourable, compared with those of its competitors, there is room to relax admission standards while maintaining strong quality. As part of its analysis, Ind-Ra will compare an independent school's quality indicators with those of its closest competitors. For specialty and boarding schools, the peer group is further expanded to include institutions serving a similar population or having a comparable academic focus. Although specialised schools for sports are rarely present in India, some schools have created a good sporting infrastructure. In line with students quality in studies Ind-Ra also focuses at students' quality in sports achievements (measured by inclusion of school pass outs in state/national sports teams in last five years).

Analysis Considers Effect of Pricing Strategies on Revenue Growth

Given that competition with one or more grant-supported, tuition-free public 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 analysed 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.

Figure 5
Attributes: Student Quality

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 competitors, with parental expectations generally met or exceeded; trends in student achievement, which periodically fluctuate, influences admissions and pricing flexibility.
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 fundraise.

Source: Ind-Ra

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, 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, Ind-Ra 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, Ind-Ra 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 on-going physical plant investment is viewed favourably in the rating process.

Figure 6
Attributes: Pricing Strategy

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 polices, 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 declining; 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.

Source: Ind-Ra

Fundraising

Contributed Funds Provide and Important Source of Support for Most Schools

Institutional development, commonly referred to as fundraising, 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.

Figure 7

Attributes: Fundraising

Stronger attributes	Long-standing fundraising 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 fundraising culture, supported by basic infrastructure needed to solicit donor contributions; annual fund giving tends to dominate, with only a few, narrowly focused campaigns to support specific initiatives.
Weaker attributes	Lackluster fundraising culture, highlighted by a spotty track record of development activities; generally no infrastructure in place to support effective fundraising, with most donations solicited on an ad hoc basis.

Source: Ind-Ra

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.

Donor Cultivation Not a Short-Term Process

While a fundraising culture is not very common in India and may take 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 fundraising prowess, Ind-Ra reviews the track record of development activities in the context of institutional mission, operating environment, and established fundraising culture.

Financial Profile

Quantitative Assessment of Factors Informs Rating Process

Financial metrics contribute significantly to rating determinations. With inputs derived from audited financial statements and other supporting financial documents, Ind-Ra calculates and evaluates quantitative assessments of revenue diversity, operating performance, balance sheet resources, and debt burden, as well as 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.

Ind-Ra analyses 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 annually is essential for maintaining or improving a school's long-term financial position and providing adequate debt service coverage.

Expenditure Flexibility Key to Operating Stability

Given the potential impact that unexpected declines in student-generated revenues could have on a school's ability to achieve budgetary balance, Ind-Ra reviews a school's expenditure flexibility, including its ability to hold constant or even decrease its total operating budget. Integral to this analysis is an assessment of significant expenditures; for most schools, costs associated with faculty salaries and related benefits are its largest expense. Generally, the lower the percentage of full-time faculty, the more flexibility a school maintains to reduce headcount during a period of financial weakness. Importantly, Ind-Ra notes the decision to reduce faculty headcount and/or replace full-time staff with part-time professionals does have implications, particularly as related to a prospective parent's view of a school's academic quality. Less favourable views of a school's student quality could have a negative enrolment impact.

Revenue Diversity

Stability of Enrolment-Driven Revenues May Offset Concentration Concerns

Ind-Ra recognises that, presently, for most private primary and secondary institutions, the ability to materially diversify away from student-generated revenue sources is limited. This fact underscores the importance of enrolment 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

Fiscal Balance Achieved Through Revenue and Expenditure Match

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 recognising that margins may vary from year to year, Ind-Ra expects at least break-even performance over a five-year period. 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.

Figure 8

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.
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 performance
Source: Ind-Ra

The exclusion of all gains and losses, including that portion of a school's annual investment payout derived from accumulated gains, will typically result in a negative operating margin. Consequently, Ind-Ra generally calculates two operating margins to better gauge operating performance. The first calculation includes a school's interest and dividend income, with no recognition of any gains or losses. Under the second calculation, Ind-Ra includes dividend and interest income and the portion of accumulated gains recognized under the endowment spending policy to the extent this amount can be obtained from financial statements.

For schools that budget for a portion of expenses to be supported by investment returns, Ind-Ra 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 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

Financial Cushion Provides Buffer

In analysing a school's resource base, Ind-Ra examines the magnitude of financial assets and the liquidity of these holdings. In general, the size of a school's resource base correlates strongly with its fundraising track record and its ability to annually operate at or above the break-even level.

For schools with significant resources, the largest component of their investment portfolio tends to be financial assets held for the long term. These assets 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 schools 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, these investments tend to be highly liquid and available on demand, with minimal notice.

To gauge the magnitude of a school's resource base, Ind-Ra calculates available funds, or total cash and investments not permanently restricted. This balance is then compared with operating expenditures and financial leverage as measures of financial flexibility. As part of its analysis of balance sheet resources, Ind-Ra 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 available fund metrics derived from those audited financial statements.

Balance Sheet Resources Not Necessarily a Proxy for Liquidity

Figure 9

Attributes: Financial Flexibility

Stronger attributes	Track record of strong/solid 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	Moderate operating performance supported by stable, enrolment-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	Weak/negative operating performance supported by variable, enrolment-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.

Source: Ind-Ra

Ind-Ra acknowledges that many schools invest sizable shares of their long-term investment portfolios in alternative asset classes. Held with a long-term investment horizon, alternative investments provide the opportunity for enhanced returns, although they are generally illiquid, not immediately accessible, and sometimes require subsequent commitments of capital.

Figure 10

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 and 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 projected MADS as a percentage of total unrestricted operating revenues. Ind-Ra considers a debt burden equal to or greater than 10% as high.

MADS – Maximum annual debt service
Source: Ind-Ra

Given these characteristics of alternative assets, which may be significant (in excess of 50% or more of a school's total investment holdings), available funds no longer provide a sufficient proxy for liquid resources. Consequently, Ind-Ra will also 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, Ind-Ra typically includes traditional equity and fixed-income investments as well as central and state government backed securities, mutual funds, and cash.

Private equity, and real estate are the most common alternative investments stripped out of the adjusted metric.

While for some schools adjusted available funds may suggest a much weaker level of financial flexibility than the traditional available funds computation, Ind-Ra recognises 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, Ind-Ra will continue to calculate available funds and adjusted available funds as measures to assess total resources and liquid resources, respectively.

Asset Allocation Evaluated in Context

Ind-Ra does not associate a target asset allocation with a particular rating level. However, a school's investment policy will be evaluated in the context of its overall financial position and financial management practices. For institutions with significant revenue concentration, stagnant demand trends, and erratic, generally negative operating performance, an asset allocation weighted toward traditional fixed income and equity investments would be more appropriate given the reliance on unrestricted, liquid reserves to subsidise operations. Overexposure to less liquid alternatives, or fluctuation in available fund balances, for such a school could have negative credit implications. In contrast, schools that are consistently able to cover annual expenditures and debt carrying charges from operating surpluses are not as dependent on balance sheet resources. Consequently, this type of institution is better equipped to handle the illiquidity risks associated with a heavy exposure to nonmarketable securities and has a greater capacity to withstand temporary, periodic fluctuations in available fund balances.

Debt Burden

Budgetary Impact of Debt-Carrying Charges Measured on an Historical Projected Basis

To assess a school's ability to annually manage its financial obligations, Ind-Ra calculates a debt burden and will review historical and projected debt service coverage levels. The debt burden, calculated by Ind-Ra as the ratio of projected MADS to unrestricted operating revenues, indicates the portion of current-year unrestricted operating revenues required to meet maximum 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 bonds payable, capital leases, and non-cancellable operating leases.

To the extent debt service is not level and large bullet maturities are utilised, Ind-Ra assesses the institution's ability to the pay bullets when due or effectuate a timely refinancing in advance of maturity dates. For upward sloping and back-loaded debt structures, Ind-Ra evaluates the reasonableness of assumptions underpinning a school's plan for ramping up operations to support higher debt-carrying charges in future years. Similar to the aforementioned variable-rate debt and swaps, non-level amortising debt structures are more likely to yield credit pressure at lower rating levels.

Other factors, notably consistently strong coverage of debt service (discussed below), may help mitigate at least some of these concerns. Ind-Ra views favourably the ability of management to articulate a well-reasoned and achievable strategy for stabilising or reducing a high debt burden over time.

Debt Service Coverage Calculated on a Legal and Economic Basis

Consistently healthy coverage of debt service may help mitigate at least a portion of the risks associated with a significant debt burden. For institutions, Ind-Ra calculates legal debt service coverage per the terms of transaction documents, using pledged revenues, and computes economic coverage based on a school's net income available for debt service (net income). Pledged revenues and net income are then compared to historical carrying charges and projected MADS. The calculation of economic coverage enables a comparison of debt manageability metrics across the non-profit institutions sector that is not possible with legal coverage, as transaction documents tend to differ from one bond issue to the next.

In calculating annual net income available for debt service (net available income), Ind-Ra begins with the change in unrestricted net assets from operations (excluding realised and unrealised 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 institution will make timely debt service payments and not rely on unencumbered liquid reserves to meet minimum coverage thresholds.

Peer Comparisons

Comparative Analysis Highlights Similarities and Contrasts Among Like Credits

Most institutions generally report demand and financial data in a standardised manner. While this standardisation enables a robust comparison among institutions having a similar mission and mix of programmatic and service offerings, comparisons across unrelated non-profit business lines will be less meaningful. As an example, the credit drivers of a voluntary institute engaged in social development differ from the drivers of a research institute, meaning that certain demand and financial metrics will not translate to both entities. Consequently, Ind-Ra generally conducts its peer analysis for institutions among credits at a given rating level having similar attributes.

In cases where Ind-Ra does not maintain ratings on a critical mass of similar credits or in situations where the metrics do not consistently align with or support a rating recommendation, Ind-Ra may expand the universe of comparable institutions. The expanded universe could include median values for dissimilar institutions at the proposed rating level or, in the case of situations on the margin, institutions rated above or below the proposed rating level. In most cases, this analysis helps bolster the rating recommendation and highlights important contrasts.

Importantly, Ind-Ra notes that the ranges over which demand and financial metrics vary can be broad, and overlap among rating categories for certain metrics is inevitable. Moreover, ratings are forward looking and imply expectations for the future rather than being solely based on what previously occurred. Nevertheless, improvement or deterioration in a school's demand and/or financial metrics is an important rating driver, with such improvement or deterioration relative to medians and peers a potential source of positive or negative rating pressure. Other intangible, qualitative variables, such as the strength of management, also play an integral role in the analysis.

Financial Metrics

Ratios Remain a Valuable Analytical Tool

Financial results correlate reasonably well with credit ratings. The table below details the core factors discussed as part of this sector-specific criteria report and provides examples of typical characteristics exhibited across the ratings spectrum.

Median financial ratios will vary over time because ratings allow for a certain amount of performance variability and cyclicality, 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.

Figure 11

Typical Independent School Credit Factors by Rating Category

	IND AAA/AA	IND A	IND BBB	Below IND BBB
Operational effectiveness	Stable or growing headcount; dominant market position; often the school of choice for the grade levels served or specialty focus (e.g. medical or engineering).	Stable or growing headcount; sound market position; while often not a school of first choice, academic program offerings are well regarded; niche institutions are also well regarded, though face at least some competition.	Generally stable headcount, although subject to increasing volatility; admissions process is somewhat competitive, although the school is rarely a first choice; average academic reputation; niche institutions are not in high demand.	Headcount subject to significant volatility; admissions process is lacklustre, with competitive strategies often reactionary; institution 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 50%) and high enrolment rates; tuition discounting is extremely manageable, supported by dedicated resources.	Sound; moderately low acceptance rates (generally 50%-75%) and moderately high enrolment rates; tuition discounting is manageable	Adequate; moderately high acceptance rates (generally 75%-90%) and moderately low enrolment rates; tuition discounting is increasingly burdensome.	Limited to extremely limited; high acceptance rates (generally 90% or higher) and low enrolment rates; tuition discounting is likely burdensome.
Fundraising	Superior; established fundraising culture and infrastructure for solicitation of robust annual fund and capital campaign donations; extremely loyal donor base, which is generally less susceptible to the cyclicality of the economy.	Sound; established fundraising culture, albeit more recent than 'IND AA/AAA' rating categories; infrastructure is in place to support robust annual giving, although history of capital campaign activity may be more limited; loyal donor base, although level of giving is susceptible to the cyclicality of the economy.	Adequate; fundraising 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 fundraising culture and no infrastructure in place to support predictable levels of annual giving; donor activity is isolated to a few examples of fundraising for building improvements, equipment, and supplies.
Revenue diversity	Diverse revenue base; operations funded from a healthy mix of student generated sources, unrestricted annual giving, and investment income; sources of support are highly stable over time.	Modest revenue concentration; operations funded primarily from student generated sources, although unrestricted annual giving and investment income may afford some diversity; sources of support are generally stable over time.	Considerable revenue concentration; operations dependent on generally stable student-generated revenue sources; annual giving is sporadic and/or insignificant, while investment income is immaterial.	Significant revenue concentration; operations are almost entirely dependent on volatile student-generated revenue sources.
Operating margin	Generally sustained track record of strong/solid operating margin,	Generally stable operating margin, both with and without recognition of endowment pay out; the institution typically has lower resource levels than its 'IND AAA' and 'IND AA' category counterparts.	Generally weak operating margin.	Generally sustained track record of weak to 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 risks of certain long-term investments are generally offset by significant short-term or intermediate-term liquid holdings.	Sound; available funds provide a solid financial cushion (generally 1.0x-3.0x) relative to both financial leverage and operating expenditures; illiquidity risks of certain long-term investments may or may not be offset by sufficient short-term or intermediate-term liquid holdings; illiquid assets tend to be a much lower percentage of total investments at the 'IND A' and 'IND A–' rating levels.	Adequate; available funds provide a reasonable financial cushion (generally 0.7x-1.0x) relative to both financial leverage and operating expenditures; schools in the 'IND BBB' rating category tend to have little or no exposure to illiquid investments. Depend largely on unsecured loans for debt servicing.	Limited to extremely limited; available funds provide only a minimal financial cushion (generally less than 0.7x) relative to both financial leverage and operating expenditures; schools in the 'IND BB' rating category generally have no exposure to illiquid investments. Depend mostly on unsecured loans for debt servicing.
Debt burden	Moderately low; most schools with a higher debt burden tend to offset the magnitude of the burden with strong coverage of pro forma debt service from net available income.	Moderate low to moderate; some schools with a higher debt burden tend to offset the magnitude of the burden with sound coverage of pro forma debt service from net available income.	Moderate to high; some schools with a higher debt burden tend to offset the magnitude of the burden with consistent coverage of pro forma debt service from net available income.	High; 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.

Source: Ind-Ra