

Philadelphia Authority For Industrial Development The Girard Estate

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Philadelphia Authority For Industrial Development

The Girard Estate

Credit Profile

US\$23.2 mil rev refunding bnds (Girard Estate) ser 2010 due 12/21/2028

Long Term Rating

A/Stable

New

Rationale

Standard & Poor's Ratings Services assigned its 'A' long-term rating to Philadelphia Authority for Industrial Development, Pa.'s series 2010 bonds, issued on behalf of the City of Philadelphia, trustee and the Will of Stephen Girard, Deceased, acting by the Board of Directors of City Trusts (The Girard Estate). The outlook is stable.

The rating reflects our assessment of:

- The estate's cash and investments of \$258 million, as of June 30, 2010, all of which is unrestricted;
- The estate's considerable, although diminished financial resources, with unrestricted resources representing 3.2x operating expenses;
- The college's mission to provide a safe and academically challenging learning environment to an underserved population; and
- The college's budgetary flexibility.

Partially offsetting credit factors include:

- The estate's high debt levels of \$155 million and complex debt structure, of which 55% is variable rate and swapped to fixed rate through three interest rate swaps that have had to post collateral;
- High annual debt service burden of 18% as of June 30, 2010, and balloon payment on a \$41.6 million mortgage due in April 2012;
- Lack of revenue diversity, relying fully on invested income to cover operating expenses; and
- High exposure to the illiquid real estate market.

The Girard Estate

In 1831, Stephen Girard bequeathed nearly his entire estate to the city of Philadelphia to establish Girard College as an institution for orphaned children in Philadelphia. Girard College opened its doors in 1848 and has been in continuous operation for 162 years. At the time of its creation, the estate was the largest private charitable donation made in the U.S. The estate is administered by the Board of Directors of City Trusts, which has statutory responsibility for all aspects of Girard College.

The estate expects to use series 2010 bond proceeds to refund the Washington County Authority, Pa.'s series 1998 bonds, issued for the estate. The series 2010 bonds will have the same maturity date as the series 1998 bonds. Post issuance, the estate will have outstanding debt of approximately \$155 million, \$112.2 million of which are bonds.

The series 2010 debt is fixed rate, the remaining bonds outstanding are variable rate, making the bond portfolio 78% variable and 22% fixed rate, the proceeds of which support Girard College. All bonds are guaranteed by the estate, and we view all debt as general obligations of the estate. The estate also has a mortgage outstanding for \$42.8 million for an office building in downtown Philadelphia, purchased as an investment. Management indicates they do not expect to issue new debt during the outlook period. The estate has three interest-rate swap agreements, which have mark-to-market values of approximately negative \$29.3 million, as of Oct. 1, 2010.

Outlook

The stable outlook reflects our expectation that the estate will balance expenses with sustainable endowment draws by the target date or sooner and that the financial resources-to-debt ratios will gradually improve.

Additional debt without corresponding growth in financial resources and continued fluctuation in endowment draws that pressure financial resources could have negative outlook or rating implications. Conversely, revenue source diversification and the proven success of leaner budgeting and maintaining smaller enrollment levels could have positive rating and outlook implications.

Governance Of The Estate

The Board of Directors of City Trusts of the city of Philadelphia oversees approximately 113 other charitable trusts for the benefit of the city, although Girard Estate funds comprises 62% of all funds managed by this board. The board has statutory responsibility for all aspects of the college. In 1996, the trust's board established the Board of Managers of Girard College to assist them in fulfilling the responsibility of governing the college. Four members of the trust's board also serve on the board of managers. The trust's board retains the right to approve the college's annual budget, appoint new members to the Board of Managers, hire and fire the college president, and change the school's mission.

Girard College

Girard College, founded in 1848, is a private boarding school for academically capable students, grades 1 through 12, from families with limited financial resources that are headed by a single parent or guardian. All Girard College students receive full scholarships to attend the school, which means that the school does not generate any of its own funds. The school is located on a 43-acre walled campus in downtown Philadelphia. In 2007, the college hired a new president, Autumn Adkins Graves, who has been integral to the school's phasing down of enrollment and cutting expenses. President Graves is also an experienced fundraiser and she has started to raise private funds to increase the college's revenue diversity.

Good Demand But Planned Enrollment Reduction Underway

Girard College functions as an independent school, although unlike other independent schools that Standard & Poor's rates, all of Girard College students receive full scholarships. Since all students are full-time boarding students and all of their expenses are covered by the college -- from school supplies to clothing, food, and transportation -- if the number of students increases, expenses increase incrementally without being offset by tuition revenue.

Applicants to the school must verify that they are from single-parent families who qualify for government-subsidized housing. Through the application process, students are required to fill out an application, get recommendations from current teachers, go through academic testing, and students and parents or guardians must interview separately at the school. Most of the students, 77% in fall 2010, come from the greater Philadelphia area, although students can apply from areas outside of the region.

The college is in the third budget year of a planned phased-enrollment reduction to counter decreased revenues available from the estate's investment portfolio. The school reached its largest size in fall 2007, with 752 students. The college experienced significant investment losses in 2008 and its resources were strained, which resulted in a decision to scale back to the school's size to between 350 and 500 students over five years.

Enrollment at the beginning of the fall 2010 school year was 532 students. Management expects to maintain high quality applicants for the target number of students. The school is scaling back class size from 50 or more students per class to 24 per class. Only the youngest students (first-graders) are being accepted as new students unless there is attrition in the older classes, although historically, Girard College has had a very low attrition rate. Ninety-five percent of Girard College students attend some form of higher education.

Ample Financial Resources With Operating Expense Reduction Plan Underway

The Girard Estate has fairly substantial financial resources, with unrestricted resources of 3.2x operating expenses (including real estate expenses) and 1.2x debt and cash and investments of 4.5x operating expenses and 1.7x debt. The operations of the estate are minimal, overhead for the operations of the estate are only \$1.8 million for administration, \$20 million for real estate expenses, which are more than covered through the real estate income generated, as well as depreciation and interest expense, which equals \$17 million combined. If we remove the estate's real estate revenue and expenses from the operations because they are self-sustaining, the cash and investments would cover operating expenses (including depreciation) at 6.9x and would cover debt (including the mortgage) at 1.7x. This leaves the foundation with ample financial resources, in our opinion, for the rating category even though the debt load is substantial.

The operations of Girard College of \$25.5 million are the largest expense of the estate, representing 45% of total expenses for fiscal 2010. It is expensive to run the college, although, in our view, expenses are easy to control through the size of the student body and leaner budgeting. Management of the estate and the college have cut expenses over the past few years, reducing the college's operating expenses by nearly 14% in fiscal years 2010 and 2011. The school expects to continue decreasing the size of its student body to bring expenses down each year for the next five years.

The estate experienced slightly negative adjusted operating performance on a full-accrual basis in fiscal 2010 (Standard & Poor's includes the investment spending draw as a revenue source), but were breakeven for the previous two years.

Good Investment Management Though High Real Estate Exposure

As of June 10, 2010, the estate's investment portfolio was valued at \$256.4 million, which decreased from a high of \$423.8 million in fiscal 2007, but has increased slightly since its low point in fiscal 2009 at \$254.5 million. This is consistent with general market volatility.

Most of the portfolio is invested in the Collective Legal Investment Fund (CLIF), which is a pooled investment fund of the assets of all the trusts administered by the board. The current target asset allocation of the CLIF is 50% equity, 10% international equity, 30% fixed income, and 10% alternative investments. In our view, this asset allocation is extremely liquid; nearly all assets could be liquid within a year, which is represented by only 1% of the total investment portfolio classified as level 3 in the estate's fiscal 2010 audit. The estate's debt retirement fund and assets held under indenture agreements, both of which appear on the balance sheet, are also invested in the CLIF. The CLIF participates in securities lending and requires 102% coverage.

In addition to the CLIF, the estate also holds a significant amount of real estate investments, which has historical ties to Stephen Girard and his bequest to the city of Philadelphia. This is represented as \$139.8 million of the \$176.9 million of property, plant, and equipment on the balance sheet; the rest is represented by the physical plant of Girard College. Real estate investments include coal-rich land in Northeastern Pennsylvania, an office tower in downtown Philadelphia, several joint-venture projects, and other real estate investments throughout the state. Real estate investments also include REITS.

The spending policy is determined based on the assets of the CLIF only. Unlike an endowed foundation, the estate is not required by law to comply with a 5% spending rule since it is legally an agency of the commonwealth. The board of directors set a 5% spending target over a 20-quarter moving average from 2001 through 2007. However, with the portfolio's sudden devaluation in 2008, the board decided to forgo their spending policy and back into their spending rate for the past few years and plan to continue to do so for the next few years until the value of the portfolio and the size of the school both stabilize. The spending policy for 2008 through 2011 has ranged between 5% and 6%.

High Debt Levels

In addition to the series 2010 bonds, the estate has three other outstanding series of bonds -- 1999, 2001, and 2002 -- all of which are variable rate. Post issuance, the estate will have outstanding debt of \$155 million. The bond portfolio consists of 78% variable and 22% fixed rate. The estate will use the series 2010 bond proceeds to refund the series 1998 bonds, which the estate used to fund construction projects at Girard College. The estate used the series 1999, 2001, and 2002 bond proceeds to fund the purchase of real estate, which the estate rents to the Commonwealth of Pennsylvania.

The series 2001 and 2002 bonds have bullet payments in fiscal year 2032. All bonds are guaranteed by the estate, and we view all debt as general obligations of the estate. The estate also has a mortgage outstanding for \$42.8 million for an office building purchased as an investment in downtown Philadelphia. The mortgage matures on April 1, 2012. The estate is currently deciding whether to refinance the mortgage, or repay all or part with reserves held in the debt reserve fund and in REITS in the investment portfolio. The estate also has three interest rate swaps outstanding.

Debt Derivative Profile: Moderate Credit Risk

Standard & Poor's has assigned the estate a Debt Derivative Profile (DDP) score of '3' on a scale of '1' to '4' with '1' representing the lowest risk and '4', the highest. The score of 3.0 indicates that the risk associated with the swaps is moderate. The estate has three floating-to-fixed rate swaps with JPMorgan Chase as the counterparty on all three.

The estate pays JPMorgan Chase a net fixed rate of 5.25% on the series 1999 bonds, 4.98% on the series 2001 bonds, and 5.31% on the series 2002 bonds and receives the Securities and Financial Markets Assn.'s index rate less 0.10% on a combined notional of \$90.82 million. The swap agreements for the series 1999, 2001, and 2002 bonds will terminate on June 1, 2027, Nov. 1, 2031, and June 1, 2032, respectively. The current mark-to-market value of the three swaps is negative \$29.3 million as of Oct. 1, 2010, and the estate has posted collateral associated with the swaps equal to this value, which are classified as "deposits held under indenture agreements" on the balance sheet.

Related Criteria And Research

- USPF Criteria: Non-Traditional Not-For-Profits, June 14, 2007
- USPF Criteria: Debt Derivative Profile Scores, March 27, 2006

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