FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Rhode Island School of Design, RI at 'A+'; Outlook Revised to Negative

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Fitch Ratings - New York - 30 Jul 2020: Fitch Ratings has affirmed the rating on approximately $200.4 million outstanding higher education facility revenue and revenue refunding bonds issued by the Rhode Island Health and Educational Building Corporation (RIHEBC) on behalf of the Rhode Island School of Design (RISD) at 'A+'.

In addition, Fitch affirms RISD's Long-Term Issuer Default Rating (IDR) at 'A+'.

The Rating Outlook is revised to Negative from Stable.

SECURITY

The higher education facilities revenue and revenue refunding bonds are an unsecured general obligation of the school, payable from legally available revenues of RISD.

ANALYTICAL CONCLUSION

The 'A+' IDR and bond rating reflect RISD's very strong demand profile, with selective admissions, and very steady FTE enrollment trends over time. The rating also reflects sufficient flexibility to manage operating costs and material near-term capital needs with good cash flow and liquidity. Fitch expects RISD's leverage position to be pressured, as it completes various planned capital projects, through a baseline and downside stress case scenario. The revision in Outlook to Negative from Stable reflects an expectation of softer enrollment in fall 2020, which will pressure operating performance and constrain RISD's financial flexibility in the near term. The outlook also reflects the additional risk possible in the event of more prolonged coronavirus impacts into 2021, including reversion to fully remote course delivery, and resultant impact on student fee revenues, and increased reliance on endowment draws and/or bank lines of credit to provide operational support. RISD will benefit from approximately $1.5 million in CARES Act funds in fiscal 2021, which will ease but not fully counter possible impacts.

Coronavirus Impacts

The ongoing coronavirus pandemic and related government-led containment measures create an uncertain environment for the U.S. public finance higher education sector. Fitch's forward-looking analysis is informed by management expectations coupled with Fitch's common set of baseline and downside macroeconomic scenarios. Fitch's scenarios will evolve as needed during this dynamic period. Fitch's current baseline scenario includes a sharp economic contraction in 2Q20 with a sequential recovery starting from 3Q20 onward. For the higher education sector, the baseline case assumes the closure of most residential campuses for a three- to four-month period with continued sporadic closures possible thereafter. RISD intends to have students on campus in fall 2020, which may include a hybrid model for classes. The school will likely have about 1,200 beds available (83% of inventory [1,447 beds]) to allow for de-densifying residential facilities, which is expected to facilitate social distancing.

Fitch's rating sensitivities address potential rating implications under a downside scenario. This scenario assumes a slower economic recovery and prolonged or recurring pandemic-induced disruptions lasting into fiscal 2021, including further tuition, auxiliary, and other related revenue pressures on the university's operations.

Revenue Defensibility: 'aa'

Strong Market Position Supports Demand

Strong demand for RISD's programmatic offerings, driven by the school's leading market position in art and design education, support historically stable enrollment trends and revenues and the 'aa' revenue defensibility assessment. RISD's demand indicators are very competitive with a very low acceptance rate and high yield and retention, and as such the enrollment base is expected to be less sensitive to price increases. RISD expects a smaller class in fall 2020 due to the coronavirus though demand metrics remain strong with record applications and acceptance rates. The assessment is constrained by RISD's reliance on student generated revenues, and endowment distributions to generate sufficient economic debt service coverage.

Operating Risk: 'bbb'

Adequate Cash Flow; Increasing Capital Needs

Operating cost flexibility is historically adequate but cash flow margins of about 13% in fiscal 2019 are thinner relative to prior years, a trend that Fitch expects will continue into 2021. RISD also has significant capital needs to absorb over the next several years under the current capital plan that Fitch believes has little flexibility as to timing, given the increasing average age of plant. RISD's approved capital plan will be scaled back in fiscal 2021 but the school plans to proceed with full funding for capital projects in 2022 with a mix of internal funds and gifts.

Financial Profile: 'a'

Adequate Financial Profile: Downside Risk

Available funds (AF) to adjusted debt of 156% in fiscal 2019, though lower than prior years due to the issuance of additional debt, reflects solid flexibility and the 'a' financial profile assessment. Heading into fiscal 2021, Fitch expects RISD's leverage position to narrow but remain resilient through a plausible market and operating stress scenario, and notes that RISD has no plans of additional debt.

ASYMMETRIC ADDITIONAL RISK CONSIDERATIONS

No asymmetric risk factors affected the rating.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Following a softer fall 2020, a rebound in demand returning to or exceeding historical pre-pandemic levels between 2350-2500 in annual FTE enrollment;

--RISD's ability to generate and sustain strong cash flow margins above 15%, which would support growth in available funds;

--Strong capital management and improved leverage ratios maintained above 160%.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Material change in demand profile or reduction in enrollment which contributes to declines in net tuition or total revenues;

--Failure to sustain sufficient cash flow margins at or above 10% needed to generate sufficient debt service coverage;

--Inability to manage the five-year capital plan and preserve leverage ratios above 90%.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579].

CREDIT PROFILE

Founded in 1877, RISD is a private four-year institution that offers 21 degree programs, including fine arts, film/animation/video, design, architecture and art education, to about 2,500 students, encompassing both undergraduate and graduate degrees. The most heavily enrolled degree programs are illustration, industrial design, architecture and graphic design. RISD's 1.9 million sf campus is located in Providence, RI with specialized facilities supporting studio-based learning. RISD's location adjacent to Brown University is favorable in supporting its Brown-RISD dual degree offerings, which has a 3% acceptance rate. RISD's regional accreditation by the New England Commission on Higher Education (formerly the New England Association of Schools and Colleges) was renewed in 2016 for a 10-year term.

REVENUE DEFENSIBILITY

RISD's headcount and FTE enrollment base is generally stable with little fluctuation, supported by a very strong demand profile. Total FTE enrollment for fall 2019 stood at 2,500 students. Of this total, about 81% are undergraduate students, and about 33% of undergraduates originate in-state.

According to management, fall 2020 applications and deposits were ahead of prior years. However, due to the coronavirus, RISD is expecting increased summer melt, with deferral of admissions and is planning for an approximately 13% enrollment loss due in part to international travel restrictions and changing financial and/or health circumstances of students. RISD is increasing financial aid by 23% in anticipation of greater financial need and expects to get to a 20% discount rate up from 18%. Management's revised enrollment budget (representing a 13% decline in enrollment) consists of 2,200 students, 1,900 of which elect to be on campus and 300 electing to be fully remote, International students account for over 50% of the remote population and their tuition is not typically discounted.

The international student cohort totals about 900 students or 36% of total enrollment, with about 177 students or 37% of the entering freshmen class (487 students) originating from abroad. Though enrollment has been fairly predictable, a modest shift can impact tuition revenues given RISD's small student base and large international cohort. Counterbalancing factors include a very strong demand profile, with 20% acceptance rate, 50% matriculation and 95% freshmen-to-sophomore retention rates supporting the 'aa' assessment for revenue defensibility.

RISD reports it is currently ahead of budgeted enrollment levels set for fall 2020, and plans to resume some form of on-campus activities in the fall. Including increased summer melt (which is generally about 5% or about 100 students per year), RISD's budgeted 13% drop in enrollment equates to an $18 million loss in tuition revenue and fees and $3.4 million in room and board and assumes the increasing institutional aid requirements. Though RISD's operations are heavily reliant on student fees (82% in fiscal 2019), RISD's historical multi-regional draw has provided a wide reach that insulated it somewhat from revenue volatility. Prior to the pandemic, RISD's strategic plan was focused on diversifying revenues, via program expansion and increased fundraising and endowment support.

RISD's reliance on its endowment to support operations is expected to grow over the near term. In fiscal 2017 and 2018, the effective spend rate was 4.8% and 4.4%, respectively. However, starting in fiscal 2019, RISD modified its spend policy to a 5% payout of the average endowment value for the previous 12 quarters for a period through fiscal 2023 to support deferred maintenance backlog and residence hall projects. In fiscal 2024, the draw rate reverts back to the current policy which is 4.75% of the previous 20-quarter average. Fitch expects this modified draw will be sustainable as RISD's investment returns have generally been greater than the effective draw rate historically. However, RISD is more susceptible to revenue volatility in a market downturn. Fiscal 2020 is expected to be ending the year with a modest 1.8% return according to management.

OPERATING RISK

Fitch calculated cash flow margins have thinned in recent years but remain adequate at 13.9% in fiscal 2019, reflecting good operating cost flexibility. Management estimates weaker operating results due to the financial impact of the coronavirus, with a $4 million net operating deficit in fiscal 2020 increasing to $13 million in fiscal 2021. This includes RISD's budgeted reductions in student derived revenues totaling $21.3 million based on a 13% enrollment loss. Expected operating adjustments from the coronavirus total $8.5 million in fiscal 2020, which are largely from room and board refunds and are budgeted at $41.5 million in fiscal 2021, before expense reductions and additional revenue sources.

To address this potential financial impact, RISD has identified and is implementing countermeasures of up to $25 million for fiscal 2021. These countermeasures include compensation and benefit reductions, hiring freeze and position reductions, furloughs, voluntary retirement and freezes on salary increases and retirement contributions.

RISD was awarded about $1.5 million of CARES Act funding, allocating half to the housing and dining cost refunds in fiscal 2020, and the remaining half to students based on need in fiscal 2021.

RISD has a significant amount of capital needs to absorb over the next five years under the current capital plan (near $140 million), including about $65 million for the Quad, a residential housing project, which will be financed in fiscal 2020 and 2021 with remaining bond proceeds from the series 2018 bonds. Further out, RISD is planning for renovations to academic buildings which would be largely financed with the Rayon Trust ($18 million gift). For fiscal 2021, RISD is reducing capital spending by $4 million to about $25 million, which is largely allocated to the quad project. RISD is also budgeting about $9 million in investments related to the coronavirus in fiscal 2021, including reconfiguring its residence halls and other common areas, technology upgrades, and cleaning and HVAC filtration. RISD expects to fund these projects with a mix of internal funds and gifts.

RISD's capital needs support the weaker assessment of 'bbb' as evidenced by its deferred maintenance needs and a high average age of plant (18 years).

RISD has a consistent track record of fundraising for its capital needs on a limited basis. Prior to the pandemic, Fitch expected RISD's efforts to grow its fundraising culture would yield results, though the current environment may hamper that somewhat.

FINANCIAL PROFILE

Fitch's calculation of leverage weakened to 156% in fiscal 2019 (from 212% in fiscal 2018) as measured by Available Funds (AF; cash and investments less permanently restricted net assets) to total adjusted debt due to the issuance of about $55 million in fixed-rate debt early in fiscal 2019. This increased RISD's overall adjusted debt to about $211 million in fiscal 2019. Fitch expects that through a period of heightened capital spending, RISD's financial profile is somewhat resilient against investment and operating stresses; however, RISD's financial profile is vulnerable prolonged investment and operating stresses in the downside scenario which could further restrict growth in available funds.

RISD recently increased its available liquidity lines with one bank to $20 million and is in process of securing additional liquidity with a second bank for added flexibility of an additional $20 million for a total of $40 million. Fitch's downside scenario assumptions includes these additional resources and an increase in the endowment spend rate to unsustainable levels, which may provide some cushion should RISD elect to switch to fully remote course delivery during fiscal 2021.

RISD does not anticipate any additional debt for new projects over the next several years. RISD has debt with a front loaded debt structure that amortizes rapidly. Over 60% of RISD's outstanding debt is fixed rate, after the recent issuance of the series 2019 bonds. The fixed-rate bonds reduced RISD's significant exposure to puttable variable rate debt (and related interest rate hedges). Outstanding variable rate demand bonds are supported by LOCs provided by TD Bank and U.S. Bank, both of which expire in 2021 and are in the process of being renewed. RISD's hedged portfolio (45% of its variable rate debt) is hedged by three interest rate swaps, provided by two counterparties. RISD has not been required to post collateral under the swap agreements.

ASYMMETRIC ADDITIONAL RISK CONSIDERATIONS

No asymmetric risk factors affected the rating.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Rhode Island School of Design (RI)	LT IDR	A+ Rating Outlook Negative	Affirmed	A+ Rating Outlook Stable
• Rhode Island School of Design (RI) /General Revenues/1 LT	LT	A+ Rating Outlook Negative	Affirmed	A+ Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

U.S. Public Finance College and University Rating Criteria (pub. 26 Mar 2020) (including rating assumption sensitivity)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v1.3.1 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Rhode Island Health & Educational Building Corp. (RI)	EU Endorsed

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