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## Iowa Higher Education Loan Authority Grinnell College; Private Coll/Univ - General Obligation

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## Credit Profile

US\$112.47 mil priv coll fac rev bnds (Grinnell Coll) ser 2017 due 12/01/2046

*Long Term Rating*

AAA/Stable

New

### **Iowa Hgr Ed Loan Auth, Iowa**

Grinnell Coll, Iowa

### **Iowa Hgr Ed Ln Auth (Grinnell College) ser 2010**

*Long Term Rating*

AAA/Stable

Affirmed

## Rationale

S&P Global Ratings assigned its 'AAA' long-term rating to Iowa Higher Education Loan Authority's series 2017 bonds issued for Grinnell College. In the meantime, we affirmed our 'AAA' long-term rating on the authority's series 2014 and 2010 bonds, also issued for the college. The outlook is stable.

Grinnell's enterprise profile was assessed as very strong based on good demand, geographically diverse student body, and strong competition for students. The financial profile is also very strong, characterized by overwhelming financial resource ratios, and positive operations in fiscal 2016 with additional endowment spending despite historical full-accrual deficits. Combined, these factors lead to an indicative stand-alone credit profile of 'aa.' The college's significant cash and investments to pro forma debt, exceptionally strong expendable resources to operating expenses and pro forma debt and solid endowment per full-time equivalent (FTE) student relative to peers in the 'AA' and 'AAA' category continue to support an 'AAA' rating.

The 'AAA' long-term rating reflects the college's unsecured general obligation pledge, supported by our view of the college's:

- Impressive endowment of approximately \$1.65 billion at June 30, 2016, which is about \$980,000 per FTE student;
- Superior financial resource ratios relative to the 'AAA' rating category, with expendable resources of \$1.6 billion as of June 30, 2016, equal to nearly 8x pro forma debt and 9.4x operating expenses;
- Stable enrollment, with good student quality and a national student draw; and
- Healthy demand metrics, although they are slightly weaker than that of 'AAA' peers.

The above factors are partially offset by the above-average debt burden, with pro forma maximum annual debt service (MADS) of about 8.6% of fiscal 2016 expenses, and the college's historical deficit operating performance on a generally accepted accounting principles (GAAP) basis, although the college consistently reported break-even results on a cash basis and limited deferred maintenance on campus in the past. We note that these results reflect the college's relatively conservative annual endowment spending at 4%. After deficit operating performances in the past few years, the

college has posted an operating surplus of \$8.1 million (4.9% margin) in fiscal 2016, mainly driven by approximately \$9.3 million in special endowment spending per year to support the college's increased debt service and select strategic investments on top of the regular 4% endowment spending. The approximately \$9.3 million per year special endowment spending has been approved by the board of Grinnell College for the period from fiscal 2016 through fiscal 2021.

The college expects to issue additional debt of about \$113 million in 2017 to provide funds (i) to partially finance the constructing, renovating, expanding, equipping, and furnishing of the Alumni Recital Hall and Carnegie Hall to create a new Humanities and Social Studies Complex (HSSC) on campus, (ii) to create, equip and furnish a new admission/financial aid center, (iii) to develop and partially implement a comprehensive campus landscaping plan, and (iv) to pay bond issuance costs. Securing the bonds is a general obligation of the college.

Founded in 1846, the college is a private, undergraduate liberal arts institution on an attractive 176-acre campus in Grinnell, about 60 miles east of Des Moines. We view enrollment as fairly stable with a full-time undergrad headcount of 1,658 for the fall 2016 semester. Most students live on campus and almost all attend full-time. The college has a healthy demand profile, in our view, demonstrated by stable enrollment, selective admissions, and a solid matriculation rate given the strong national competition for its high-quality students.

### **Rating above the sovereign**

Grinnell's revenue bonds are rated above the sovereign because we believe the institution can maintain better credit characteristics than the U.S. in a stress scenario. Under our criteria, "Ratings Above The Sovereign: Corporate And Government Ratings—Methodology And Assumptions," U.S. colleges and universities are considered to have moderate sensitivity to country risk. Grinnell's revenues are the sole source of security on the bonds, the institutional framework in the U.S. is predictable with institutions like Grinnell having significant autonomy, independent treasury management, and no history of government intervention. The large endowment, which has a substantial market value and is invested globally, a relatively low debt level, and the largely serial amortization of the debt portfolio, provide financial flexibility.

## **Outlook**

The stable outlook reflects our expectation that the college will maintain superior financial resource ratios in the next two years, supported by stable enrollment, good demand and enrollment management practices, and break-even to positive operating performance on a GAAP basis. We understand that the college does not expect to issue additional debt in the next three years.

### **Downside scenario**

We do not expect a downward rating action during the outlook period given the college's exceptional balance sheet, conservative 4% endowment draw, and good liquidity from operating and capital reserves. Significant debt issuance or very substantial resource ratio deterioration could pressure the rating.

## **Enterprise Profile**

### **Industry risk**

Industry risk addresses the higher education sector's overall cyclical and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, levels and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the higher education sector represents a low credit risk when compared with other industries and sectors.

### **Economic fundamentals**

In our view, the college has good geographic diversity, drawing students nationally and internationally. Over 90% of students come from outside of Iowa. As such, our assessment of Grinnell's economic fundamentals is anchored by the U.S. GDP per capita.

### **Market position and demand**

Full-time undergraduate headcount was 1,658 in fall 2016, which was in line with the past few years. In our view, student quality is very good, the geographical draw is national, and the demand profile is good, although slightly weaker than other 'AAA' peers. We expect that the college will retain a similar enrollment level and demand profile in the next few years.

Overall admissions remains selective, with 20% of fall 2016 applicants accepted, which is slightly stronger than earlier years. The fall 2016 matriculation rate was solid at 28%, consistent with previous years. These demand metrics are solid considering the highly competitive national market in which Grinnell operates. The college has broad geographic diversity, typically with less than 50% of its student body coming from the Midwest, and only about 8% from Iowa. Grinnell's main competitors are Carleton College (Minn.), Oberlin College (Ohio), and Macalester College (Minn.).

Student quality is consistently high, with fall 2016 freshmen reporting average SAT and ACT scores of 1415 and 31, respectively. The college had a tuition discount rate of about 61% in fiscal 2016, a mix of need- and merit-based scholarships. This is consistent with Grinnell's longstanding need-blind admissions policy, representing its commitment to meeting 100% of demonstrated needs. We note that our calculation of tuition discount for Grinnell includes both grants and scholarships and tuition remission. If excluding the \$1 million tuition remission, the tuition discount rate would be slightly lower at about 60% in fiscal 2016. We believe that although the discount rate is high compared with peers, it will remain relatively flat or slowly decline over the next few years, consistent with the college's strategic priorities. The tuition discount is funded through the college's generous endowment.

The college does not have a strong history of fundraising. Until now, it had only one comprehensive capital campaign, which ended in 2005 and raised \$89 million in gifts and pledges, in excess of the original goal of \$75 million. The college is currently in the silent phase of a new comprehensive campaign with a goal yet to be finalized, which will include a target of approximately \$20 million in capital fund gifts to support major building and improvement projects on campus. Current fundraising efforts are largely targeted at the annual fund and at strategic capital projects with a goal of building infrastructure and a culture of giving among current students, alumni, and friends. The college raised about \$5.3 million in annual giving for operations and \$9.2 million to capital and endowed funds in fiscal 2016, which was consistent with previous years. We would view improved fundraising as a positive factor with regard to revenue

diversity.

### **Management and governance**

Since the president's appointment in 2010, nearly all senior management positions have turned over, many of which occurred in the past three to four years. Since then, the team has been generally stable except for a new vice president of communications with more than 25 years of related experience joining in October 2016, after the former manager left for another college.

Overall, the college has conservative practices, although management does not budget for full depreciation, which results in historical full-accrual deficits. We would view a change in this practice positively. Management reports that the college does fund its facility maintenance expenses through a combination of the operating budget and two reserve funds, and the funding demand is projected on a one-year, five-year, and 20-year outlook that is updated at least once annually.

The college adopted a strategic plan in June 2012 that focuses on six core priorities, spanning the lifecycle of an individual's experience with Grinnell, from prospective student to alumni, supported by strategic deployment of necessary infrastructure. Portions of this plan include implementation of an enterprise risk management system, and strategic hires in communications, development, and enrollment to identify opportunities to improve net student revenues and fundraising. The strategic plan is funded through a combination of the operating budget and a strategic reserve fund supported by the endowment draw. The strategic reserve is funded by a portion of the college's 4% endowment draw policy and does not include additional draws, which we believe is conservative.

In fiscal 2016, the board approved the administration's proposal to create and fund a portfolio of reserves with a combined target value of \$100 million to mitigate risks and also support strategic initiatives. Management reports that three of the reserves already exist, but that the balances will be supplemented to higher target levels. Two new reserves will be created to provide added risk mitigation and agility in response to opportunities. Phased allocations from the endowment will fully fund all five reserves by fiscal 2022.

## **Financial Profile**

### **Financial management policies**

The college has formal policies for endowment, investments, and debt. It operates according to an actively managed, ongoing strategic plan, and has a formal reserve and liquidity policy. The college meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, while there may be some areas of risk, the organization's overall financial policies are not likely to negatively affect its future ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure and a comparison of these policies to comparable universities. We consider many of the college's policies best practices and view management as conservative.

## **Financial performance**

Grinnell's operating performance over the past few years has been characterized by operating deficits on a full-accrual basis and moderate revenue diversity. However, it posted an operating surplus of \$8.1 million in fiscal 2016, or a positive margin of 4.9%, largely driven by the special endowment spending of \$9.3 million on top of the regular endowment spending in fiscal 2016. Management expects similarly positive results for fiscal 2017. To support the implementation of the college's strategic plan as well as the increased debt service for the additional debt, the board has approved a special endowment distribution of about \$9.3 million special endowment spending per year, on top of the regular endowment spending, for the period from fiscal 2016 through 2021. Despite a very high, but stable, discount rate of 61.2% in fiscal 2016, net tuition revenue increased from the previous year. Management's key focus is to maintain continued growth in net tuition revenue over the next few years to manage the downside risk of the college's relatively high reliance on endowment spending for operating revenue. Although we believe that the college has a strong financial profile, we would view stronger revenue diversity and GAAP surpluses positively.

The college has moderate unrestricted revenue diversity, with 44.2% of revenues coming from tuition and fees, 42.4% from endowment and investment income, 9.6% from auxiliaries, 2.5% from other sources, and only 1.3% from unrestricted gifts. Relative to its 'AAA' peers, the diversity is rather limited, given that 96% of revenues are derived from student-generated or investment-related revenues. Although management is making efforts to improve fundraising, the mix of revenues is unlikely to change over the two-year outlook period.

## **Financial resources**

Financial resource ratios are excellent and well above the 'AAA' rating category medians due to the college's large unrestricted endowment and conservative endowment spending rate. Expendable resources for the fiscal year ended June 30, 2016, were \$1.6 billion, an impressive 9.4x adjusted operating expenses, and nearly 8x outstanding pro forma debt. Cash and investments were similarly superior at \$1.7 billion, equal to 10x operating expenses and 8.5x pro forma debt. We expect financial resource ratios, even after taking into account additional debt to be issued in 2017, to remain exceptionally strong, and still well in excess of many 'AAA' peers.

Grinnell's endowment is largely unrestricted, and management indicates its growth during the past two decades is due largely to the college's investment strategy, planning, and budget discipline, rather than fundraising. The endowment's market value as of June 30, 2016, was \$1.65 billion, of which approximately \$1.1 billion was unrestricted. As of the same date, the endowment asset allocation was about 46% equities, 13% absolute return/hedged, 29% private equity, 9% cash and fixed income, and 3% real assets. This mix has not changed materially during the past two years, and we do not expect it to change in the future. The investment portfolio provides sufficient liquidity for its size, in our view. Management estimates that approximately 44% of assets could be liquidated in a week or less, and 60% within a year. We understand that unfunded capital commitments as of Sept. 30, 2016 are about 15% of the portfolio, which we consider conservative relative to peer institutions with similar-sized endowments.

## **Debt and contingent liabilities**

Debt totaled \$86 million at June 30, 2016, and post-issuance of the series 2017 bonds, pro forma debt will be around \$199 million. All debt is fixed rate with no swap contracts. We believe this fixed-rate debt profile is conservative and eliminates put and interest-rate risk. Financial resource ratios relative to debt are exceptional relative to peers, and we would expect that to remain stable. The pro forma MADS burden is a reasonable 8.6% of fiscal 2016 operations, which

reflects the college's somewhat frontloaded debt service schedule. Management indicated that the MADS burden would marginally decrease if calculated based on fiscal 2017 budgeted operations.

	--Fiscal year ended June 30--					Medians for 'AAA' rated private colleges and universities
	2017	2016	2015	2014	2013	2015
<b>Enrollment and demand</b>						
Headcount	1,699	1,705	1,734	1,721	1,674	MNR
Full-time equivalent	1,671	1,678	1,693	1,683	1,635	11,757
Freshman acceptance rate (%)	20.2	24.9	28.0	30.5	32.0	10.1
Freshman matriculation rate (%)	27.8	27.7	25.6	30.3	30.5	MNR
Undergraduates as a % of total enrollment (%)	100.0	100.0	100.0	100.0	100.0	45.7
Freshman retention (%)	93.0	94.0	94.0	93.0	95.0	98.0
Graduation rates (five years) (%)	86.0	84.0	84.0	89.0	85.0	MNR
<b>Income statement</b>						
Adjusted operating revenue (\$000s)	N.A.	174,569	156,813	148,532	139,601	MNR
Adjusted operating expense (\$000s)	N.A.	166,494	163,879	155,645	145,916	MNR
Net operating income (\$000s)	N.A.	8,075	(7,066)	(7,113)	(6,315)	MNR
Net operating margin (%)	N.A.	4.85	(4.31)	(4.57)	(4.33)	4.77
Change in unrestricted net assets (\$000s)	N.A.	(97,054)	(9,279)	180,088	112,619	MNR
Tuition discount (%)	N.A.	61.2	62.5	63.0	61.7	40.2
Tuition dependence (%)	N.A.	44.2	48.1	48.2	46.9	MNR
Student dependence (%)	N.A.	53.8	58.5	58.2	57.1	30.5
Research dependence (%)	N.A.	0.3	0.4	N.A.	N.A.	MNR
Endowment and investment income dependence (%)	N.A.	42.4	38.0	37.8	39.2	MNR
<b>Debt</b>						
Outstanding debt (\$000s)	N.A.	85,820	91,720	101,205	107,105	1,757,988
Proposed debt (\$000s)	N.A.	113,085	N.A.	N.A.	N.A.	MNR
Total pro forma debt (\$000s)	N.A.	198,905	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	14,291	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	5.88	5.44	5.06	5.61	MNR
Current MADS burden (%)	N.A.	5.74	5.83	6.05	6.61	5.61
Pro forma MADS burden (%)	N.A.	8.58	N.A.	N.A.	N.A.	MNR
<b>Financial resource ratios</b>						
Endowment market value (\$000s)	N.A.	1,648,783	1,787,775	1,829,521	1,553,629	8,613,547
Cash and investments (\$000s)	N.A.	1,694,221	1,831,256	1,872,011	1,605,858	MNR
Unrestricted net assets (\$000s)	N.A.	1,281,920	1,378,974	1,388,253	1,208,165	MNR
Expendable resources (\$000s)	N.A.	1,556,666	1,698,597	1,718,500	1,459,207	MNR

**Grinnell College, IA (cont.)**

	--Fiscal year ended June 30--					Medians for 'AAA' rated private colleges and universities
	2017	2016	2015	2014	2013	2015
Cash and investments to operations (%)	N.A.	1,017.6	1,117.4	1,202.7	1,100.5	878.9
Cash and investments to debt (%)	N.A.	1,974.2	1,996.6	1,849.7	1,499.3	803.7
Cash and investments to pro forma debt (%)	N.A.	851.8	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	935.0	1,036.5	1,104.1	1,000.0	677.5
Expendable resources to debt (%)	N.A.	1,813.9	1,851.9	1,698.0	1,362.4	648.3
Expendable resources to pro forma debt (%)	N.A.	782.6	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	18.0	17.5	15.5	13.8	12.1

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.



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