

CREDIT OPINION

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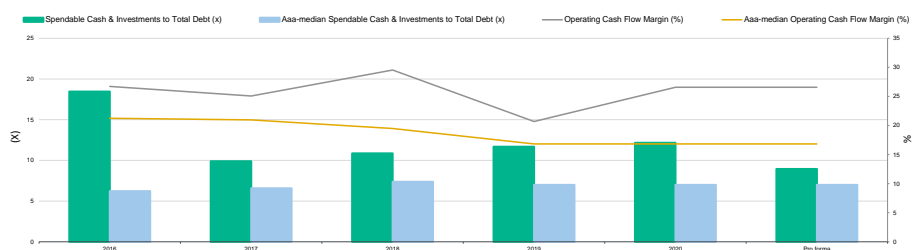
Grinnell College, IA

Update to credit analysis

Summary

[Grinnell College, IA's](#) (Aaa stable) exceptional credit quality is anchored by its robust unrestricted financial reserves, consistently excellent operating performance, and continued solid student demand. Available financial resources provide exceptional coverage of operations and debt and available monthly liquidity remains extraordinarily strong despite shifts in endowment investments to less liquid assets in recent years. Operating cash flow margins are consistently above 20%, and even with negative impacts from the COVID-19 pandemic, management's estimates point towards a still solid operating cash flow margin well above 15%. Before the pandemic, Grinnell had favorably grown net tuition revenue over multiple years, despite operating in a very competitive student market and having a need-blind admissions policy. Management expects a return of net student charges revenue growth in fiscal 2022 and operating cash flow near historical levels.

Offsetting credit considerations include a high debt to cash flow, a small operating base, a high reliance on investment income to fund operations, and historically weaker philanthropy. Proposed new bonds are in bullet form and increases the college's debt beyond historical levels, illustrating some changes to the college's risk appetite. The college does have concentration risk in its investment portfolio with about a quarter of investments under one private capital management group.

Exhibit 1
Excellent operating cash flow and substantial unrestricted endowment reserves supports Grinnell's exceptional credit quality


Fiscal 2020 and pro forma median data use fiscal 2019 medians.

Source: Moody's Investors Service

Credit strengths

- » Exceptionally strong balance sheet, with \$2.2 billion of total cash and investments including over \$2 billion that is unrestricted, supporting mission and strategic initiatives for sustainable growth
- » Extraordinary unrestricted endowment and reserves, with \$512 million of monthly liquidity or 1,521 monthly days cash
- » Consistently excellent operating performance with a five-year average annual operating cash flow margin above 25%
- » Solid student demand from Grinnell's national reputation as a competitive need blind liberal arts college meeting demonstrated need

Credit challenges

- » Highly reliant on investment income at 64% of total operating revenue for fiscal 2020, requiring careful endowment management because of potential investment volatility
- » Very high competition for students reflected in a 23% yield rate in fall 2020, lower than other Aaa-rated colleges
- » Investment concentration risk with one private capital management group overseeing about a quarter of the college's investments
- » Improving, but still weaker gift revenue compared with peers

Rating outlook

The stable outlook reflects our expectations that operating performance in fiscal 2022 will mirror pre-pandemic levels. It additionally assumes no additional debt and continued growth in investments.

Factors that could lead to an upgrade

- » Not applicable

Factors that could lead to a downgrade

- » Notable balance sheet weakening
- » Additional debt issuance in the near-term, including a move to total debt to cash flow above 9x
- » Multiple years of weakened operating performance

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Key indicators

Exhibit 2

GRINNELL COLLEGE, IA

	2016	2017	2018	2019	2020	Pro Forma	Median: Aaa Rated Private Universities
Total FTE Enrollment	1,660	1,664	1,681	1,701	1,470	1,470	9,883
Operating Revenue (\$000)	142,905	147,204	152,267	155,049	161,273	161,266	1,714,502
Annual Change in Operating Revenue (%)	8.1	3.0	3.4	1.8	4.0	4.0	4.4
Total Cash & Investments (\$000)	1,694,221	1,938,888	2,061,141	2,147,833	2,167,564	2,167,564	12,610,557
Total Debt (\$000)	85,820	184,375	178,475	172,575	166,675	221,870	1,583,774
Spendable Cash & Investments to Total Debt (x)	18.5	9.9	10.9	11.7	12.2	9.1	7.0
Spendable Cash & Investments to Operating Expenses (x)	13.3	14.5	15.4	14.5	14.9	14.9	7.8
Monthly Days Cash on Hand (x)	2,541	2,802	2,622	2,256	1,521	1,521	741
Operating Cash Flow Margin (%)	26.7	25.1	29.5	20.7	26.6	26.6	16.8
Total Debt to Cash Flow (x)	2.2	5.0	4.0	5.4	3.9	5.2	5.6
Annual Debt Service Coverage (x)	3.9	3.3	3.1	3.1	4.2	3.1	3.0

Pro forma column includes proposed new debt and debt service and fiscal 2020 financial statement information.

Source: Moody's Investors Service

Profile

Grinnell College is a small private, not-for-profit college located in Grinnell, IA. In fiscal 2020, Grinnell generated operating revenue of \$161 million and enrolled 1,470 full-time equivalent (FTE) students as of fall 2020. The college is highly selective while committed to financial access, being both need-blind and meeting 100% of an accepted student's demonstrated need.

Detailed credit considerations

Market position: solid national student demand will continue despite significant competition for students; historically weaker philanthropy is improving

An excellent strategic position will continue, supported by Grinnell's solid national student demand and improving philanthropy. Grinnell recruits in a very crowded field of highly selective liberal arts colleges, but the college's need-blind admission and commitment to fully meeting the financial needs of admitted students is a market differentiator, which will be boosted by plans to have a "no loan" policy for students demonstrating need. Despite this market differentiation and resulting strong student demand, Grinnell does lag peers' student market metrics. Selectivity at the college in 2020 was 19.2% and resulting yield was 23.3%, solid, but weaker than peers of similar credit quality as many peers have selectivity below 10% and yield above 35%.

Like many other small liberal arts colleges, Grinnell had a decline in students in fall 2020 because of the COVID-19 pandemic, with full-time equivalent (FTE) students totaling 1,470 FTE students compared with 1,701 FTE students in fall 2019. Grinnell had only a few students on campus in the fall and welcomed approximately 425 students to campus in the spring term 1. Barring setbacks in COVID-19 transmission locally and nationwide, management expects more normal operations in student numbers in the fall 2021.

Grinnell has favorably improved philanthropy in recent years, with three-year average gift revenue totaling \$18.8 million in fiscal 2020, up nearly 18% since fiscal 2016. The college is currently in a fundraising campaign that originally had a goal of \$150 million, which it favorably surpassed, hitting \$187 million. Management anticipates surpassing \$200 million by June 30, 2021. Improving philanthropy has been a strategic focus of senior leadership in recent years, as the college has historically lagged its peers in alumni giving.

Operating performance: consistently strong operating performance driven primarily by strong endowment growth and prudent expense management

Despite operating challenges stemming from the pandemic, Grinnell will produce a still solid operating cash flow margin in fiscal 2021, with management expecting more normal operating performance in fiscal 2022. Operating cash flow in fiscal 2020 was strong despite refunding students for room and board during spring because of the pandemic, with an operating cash flow margin of 26.6%, better than peers of similar credit quality. Resulting annual debt service coverage was a solid 4.2x.

Because of net tuition and auxiliary losses stemming from the pandemic, management is budgeting for erosion in operating performance for fiscal 2021. Favorably, management made swift expense reductions, including salary and hiring freezes, cuts to discretionary spending, and some halting of capital spending. Based on management's provided forecast, we estimate that Grinnell will still produce an operating cash flow margin well above 15x and pro forma debt service well over 2x. Management is still developing its fiscal 2022 budget, but is planning for an operating expense base at 90% of the college's 2020 level, demonstrating strong expense discipline.

Grinnell is highly reliant on investment income to fund operations, though the college has favorably improved net tuition revenue by over 18% since fiscal 2016. Investment income comprised 64% of revenue in fiscal 2020, which will increase in fiscal 2021 because of lost net tuition and room and board revenue. Over the past few years, Grinnell's endowment draw has been 4.5%, slightly higher than the target 4% to fund strategic investments in reserve funds. Management expects to return to its target rate in fiscal 2022.

Wealth and liquidity: exceptionally strong balance sheet and extraordinary unrestricted reserves and liquidity

Substantial balance sheet reserves will continue as the primary credit factor underpinning Grinnell's credit quality. In fiscal 2020, total cash and investments totaled \$2.2 billion with over \$2 billion in unrestricted form. (Early estimates from management at the end of December 2020 point toward a significant increase in endowment value, driven by investment returns.) Spendable cash and investments cover operating expenses an extraordinary 14.9x, well above peers.

A significant percentage, nearly 63%, of the college's endowment is in illiquid and structured investments, evidencing an appetite for nonmarketable investments, though the college's liquid reserves are very robust and partially mitigate this exposure. Additionally, the college does have some concentration risk in its investment portfolio, with one manager currently holding about 25% of its endowment investments. Investment returns in fiscal 2020 were good compared with peers at over 5% and management reports strong returns since the end of fiscal 2020 (based on preliminary unaudited valuations for a majority of investments held in the endowment). The college has an experienced investment team with an in-house chief investment officer and a total of five members in the investment office.

Liquidity

Grinnell's liquidity remains very robust with total available of \$512 million, resulting in 1,521 monthly days cash on hand. Annual liquidity totaled \$804 million and provides an extraordinarily strong 2,388 monthly days cash on hand. Liquidity reserves have decreased in recent years because of changes to the college's investment allocation and working capital policies, but will remain exceptional given the college's smaller scope and sizable unrestricted reserves. The college does have continued exposure to unfunded commitments, totaling \$281 million in fiscal 2020.

In addition to its assets, the college has an outstanding line of credit at \$30 million which it has not drawn on.

Leverage: proposed debt issuance will elevate debt to cash flow; financial reserves continue to provide a strong debt and operating buffer

Recent and proposed debt issuances will produce elevated debt to cash flow, though spendable cash and investments coverage of debt will remain exceptionally strong. Pro forma debt to cash flow, despite strong cash flow in fiscal 2020, is elevated at 5.2x, which will worsen in fiscal 2021 because of expected thinner performance. Management is expecting improved operations in fiscal 2022, which should keep debt to cash flow manageable barring additional debt issuance. Offsetting the elevated debt to cash flow is exceptionally strong fiscal 2020 spendable cash to pro forma debt coverage of 9.1x, materially better than most similarly rated peers.

Legal security

All of the college's debt, including proposed Series 2021 bonds, are unsecured general obligations of the college and are on parity.

Debt structure

Proposed Series 2021 bonds introduces some debt structure risk to Grinnell. The current proposed structure is interest only until a bullet payment is scheduled in fiscal 2052.

Debt-related derivatives

None

Pensions and OPEB

Grinnell's retirement benefit costs are manageable, representing about 4% of fiscal 2020 operating expenses. The college offers a defined contribution plan through TIAA and contributed \$5.6 million in fiscal 2020. Grinnell does offer retiree healthcare benefits with both the college and participants contributing. In fiscal 2020 the college's net periodic benefit costs was \$1.6 million and the associated liability was \$19.8 million.

ESG considerations

Environmental

Environmental considerations are not currently a key credit driver for Grinnell College, but its location (Grinnell, Iowa) does expose it to extreme storm events, with a recent derecho causing power outages and tree damage on campus. To minimize potential negative impacts, the college has an extensive emergency notification network on campus as well as strong working relationships with local officials and power providers. Additionally, the college's location in Grinnell, Iowa exposes it to high heat stress and moderate water stress.

Social

Grinnell, like other colleges and universities, primary social consideration over the near-term is the COVID-19 pandemic. Grinnell took a conservative approach in the fall, with online only coursework and housing only a very limited number of students on campus. Management did decide to bring a limited number of students on campus in the spring and is planning to have more normal operations in the fall. Limited campus capacity will erode performance in fiscal 2021 and did lead to an enrollment decline with a number of students deferring for the year, but management expense reductions will limit performance downside. Additionally, the college is anticipating a full class size in the fall with a return to normal operations on campus.

Grinnell's location in Iowa and Midwest region does expose it demographic pressures in-state and in the region; however, its ability to recruit nationwide mitigates these challenges. Additionally, the college's extraordinary wealth for its size provides it with the resources necessary to recruit students regardless of income level, a positive.

Governance

Grinnell has historically strong governance, illustrated by strong endowment management, a sound student market position, and exceptional cash flow generation and fiscal discipline. The college is working toward improving its two primary weaknesses compared with peers: philanthropy and yield. Recent new debt and proposed new debt, as well as recent elevated investment manager risk, does demonstrate some risk appetite change for the college, though manageable given the college's sizable resources and historically strong cash flow generation. A new president was appointed in July 2020, replacing the prior president that served for nearly 10 years. The new president previously served as vice president for academic affairs and dean of the College and expectations are for a seamless transition.

Grinnell's board is diverse and large with 29 members (26 regular and 3 ex officio) coming from various backgrounds. Board members are elected to serve a four year term and can serve for four consecutive, full terms. The board meets quarterly and holds other meetings as necessary.

Rating methodology and scorecard factors

The principal methodology used in this rating was [Higher Education](#) published in May 2019. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology. The Higher Education Methodology includes a scorecard that summarizes the factors that are generally most important to higher education credit profiles. Because the scorecard is a summary and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not match an assigned rating. We assess strategic positioning on a qualitative basis, as described in the methodology.

The two notch distinction between the scorecard indicated outcome and the assigned rating reflects Grinnell's substantial unrestricted endowment and reserves that provide extraordinary coverage of debt and operations. Additionally, it reflects the college's historical commitment to producing excellent cash flow margins and protecting the spending power of its endowment.

Exhibit 3

Grinnell College, IA

Scorecard Factors and Sub-factors	Value	Score
Factor 1: Market Profile (30%)		
Scope of Operations (Operating Revenue) (\$000)	161,266	A1
Reputation and Pricing Power (Annual Change in Operating Revenue) (%)	4.0	A3
Strategic Positioning	Aa	Aa
Factor 2: Operating Performance (25%)		
Operating Results (Operating Cash Flow Margin) (%)	26.6	Aaa
Revenue Diversity (Maximum Single Contribution) (%)	63.5	A3
Factor 3: Wealth & Liquidity (25%)		
Total Wealth (Total Cash & Investments) (\$000)	2,167,564	Aa1
Operating Reserve (Spendable Cash & Investments to Operating Expenses) (x)	14.9	Aaa
Liquidity (Monthly Days Cash on Hand)	1,521	Aaa
Factor 4: Leverage (20%)		
Financial Leverage (Spendable Cash & Investments to Total Debt) (x)	8.9	Aaa
Debt Affordability (Total Debt to Cash Flow) (x)	5.2	Aa3
Scorecard-Indicated Outcome		Aa2
Assigned Rating		Aaa

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.

For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.

Source: Moody's Investors Service

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