

CREDIT OPINION

PRIVATE MONITORED RATING

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Point Loma Nazarene University, CA

Update - Moody's Upgrades Point Loma Nazarene's University (CA) Issuer Rating to Baa1; Outlook Stable

Summary Rating Rationale

Moody's Investors Service has upgraded Point Loma Nazarene University's (PLNU) issuer rating to Baa1 from Baa2 reflecting strengthening enrollment, translating to multi-year and above-average revenue and reserve growth. The outlook is stable.

The upgrade to Baa1 is supported by strong student demand in the San Diego metropolitan area, as evidenced by growing net tuition revenue. The university's ability to grow its enrollment while controlling expense growth underscores our expectations for continued strong cash flow, which will bolster reserves in the future. The rating is further supported by the university's manageable financial leverage and debt affordability. Offsetting factors include a high dependence on student charges as well as weaker fundraising and lower wealth relative to peers.

Credit Strengths

- » Strong 24% enrollment growth among graduate students and those completing undergraduate degrees over the last five years
- » Pricing power resulting in high net tuition per student of \$23,610, 19% above the Baa median
- » Strong operations with an operating cash flow margin of 16% in FY 2016 leading to a 50% increase in total cash and investments since FY 2012
- » Affordable debt with a three-year average debt service coverage of over 5 times

Credit Challenges

- » Highly concentrated revenue sources, with almost 90% of revenues derived from student charges
- » Main campus enrollment cap of 2,000 full-time equivalent (FTE) students requires offsite locations for growth
- » Absence of a strong donor base, with \$1,966 in 3-year average gifts per student (FY 2014 – 2016)

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Rating Outlook

The stable outlook reflects our expectation that the university will continue to produce solid net tuition revenue growth, with strong cash flow translating to continued growth of reserves from operating surplus.

Factors that Could Lead to an Upgrade

- » Material growth of financial reserves relative to debt and peers
- » Above-average growth in enrollment and net tuition revenue

Factors that Could Lead to a Downgrade

- » Significant deterioration in operating cash flow margin
- » Substantial new debt relative to cash and investments

Key Indicators

Exhibit 1

Point Loma Nazarene University, CA

	2012	2013	2014	2015	2016
Total FTE Enrollment	2,748	2,849	2,859	3,101	3,395
Operating Revenue (\$000)	84,183	86,610	90,992	95,151	102,152
Annual Change in Operating Revenue (%)	2.2	2.9	5.1	4.6	7.4
Total Cash & Investments (\$000)	57,069	65,798	78,332	78,854	86,054
Total Debt (\$000)	32,116	31,166	31,600	40,551	48,103
Spendable Cash & Investments to Total Debt (x)	1.2	1.5	1.8	1.4	1.3
Spendable Cash & Investments to Operating Expenses (x)	0.5	0.6	0.7	0.7	0.7
Monthly Days Cash on Hand (days)	178	227	295	217	231
Operating Cash Flow Margin (%)	11.1	13.1	14.9	16.1	16.3
Annual Debt Service Coverage (x)	3.8	4.5	5.4	5.6	5.4

Sources: Moody's Investors Service

Detailed Rating Considerations

Market Profile: Strong Enrollment Growth Supported by Diversified Programmatic Offerings

Point Loma Nazarene University has experienced rapid enrollment growth through successful implementation of strategic program development. Over the last five years, undergraduate full-time equivalent enrollment (FTE) has grown 18% and graduate FTE enrollment has grown a remarkable 51%. Growth is expected to continue for fall 2017. Undergraduate enrollment growth is largely due to the launch of an adult degree completion program starting in fall 2014. In fall 2016, the university reported 400 non-traditional students enrolled in degree completion programs. The program targets students who graduate from the California community college system and want to complete a baccalaureate degree. Currently, non-traditional students make up a little under 10% of headcount enrollment, and we expect the university will continue to expand this program.

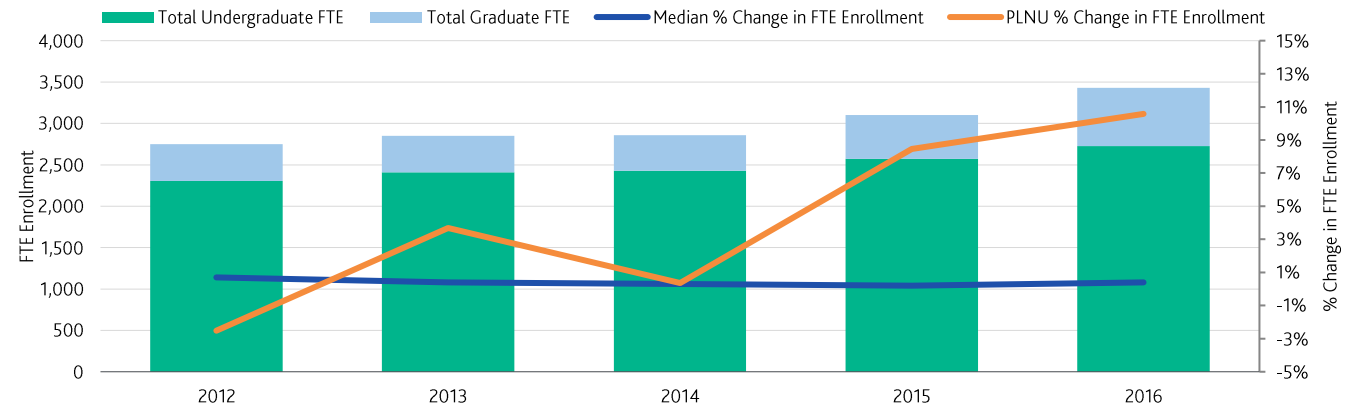
Improved demand and rising net tuition per student have been bolstered by the university's high-demand health science programs, which represent about 40% of enrollment. PLNU recently launched new graduate programs in kinesiology and clinical counseling,

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which have helped to spur graduate demand. Growth in more expensive graduate programs has contributed to the university's growing net tuition per student to \$23,610 in fiscal 2016, up 12% from \$21,078 in fiscal 2012.

Exhibit 2

Point Loma Nazarene's University Enrollment Growth Far Outpaces Sector
FTE Enrollment (left axis) vs. % Change in FTE Enrollment



Note: Medians dataset represents all rated private universities

Sources: Moody's Investors Service

A conditional use permit, set by the City of San Diego on PLNU's main campus, tempers growth, forcing the university to utilize offsite locations. Undergraduate enrollment on the main campus is capped at 2,000 FTEs through the conditional use permit. As a result, PLNU relies heavily on off campus locations to grow undergraduate enrollment. The university also leases buildings near the campus and operates multiple branch locations which has allowed total enrollment to grow despite the cap.

The university is well-positioned to maintain healthy in-state enrollment even if state financial aid (Cal Grants) is cut as put forth by the governor in his recently proposed budget. If necessary, the university would backfill any potential loss of state financial aid with its own resources. If the governor's proposal is adopted, the university estimates that they would have to increase financial aid by \$500,000.

Operating Performance: Strong Cash Flow, But High Revenue Concentration

The university's strong revenue growth, driven by rising enrollment, and moderate expense growth is expected to continue in fiscal 2017. Enrollment growth has been instrumental in consistent top-line revenue growth at an average of 5.7% annually over the last five years, outpacing average expense growth of 4.6%. The operating cash flow margin increased to 16% in fiscal year 2016, exceeding the Baa median of 14.2%. The upgrade to Baa1 is predicated on expectations of continued strong cash flow and retained surpluses. The university expects moderate salary and benefits increases in FY 2017, estimated at 3%, though below expected revenue growth.

Countering the university's strong operating cash flow margin is the PLNU's weak revenue diversity, with almost 90% of revenues derived from student charges. However, there is some diversification within the 90%, with undergraduate tuition representing 74% of total net tuition revenue, graduate tuition representing 20%, and 6% from adult degree completion programs.

Wealth and Liquidity: Strong Operating Performance Adds Cushion to Balance Sheet

Multiple years of strong cash flow generation has led to an above-average 50% increase in total cash and investments over the last five years, allowing the university to invest in strategic capital needs. Despite the recent growth in reserves, PLNU's spendable cash and investments to operating expenses of 0.7 times is slightly below the Baa median of 0.9 times. PLNU invested roughly \$50 million in the FY 2012-16 period in capital enhancements, reducing the university's age of plant to a competitive 11 years. The

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university's most comprehensive project was the addition of a new science building, which serves as a critical component of the university's health science mission.

The university's limited fundraising ability hinders its ability to grow cash & investments outside of its core operations. Total gift revenue in FY 2016 was \$6.2 million, about \$1 million below the Baa median.

The university's endowment is managed by an external Chief Investment Officer and has a conservative asset allocation with approximately 75% of assets invested in publicly-traded equities and fixed income. The endowment spend rate is moderate at 4% and management has no plans to change this moving forward.

LIQUIDITY

The university has solid liquidity for its size of operations, reporting 231 monthly days cash on hand in FY 2016. The university's liquidity is bolstered by a \$5 million operating line of credit held with [First Republic Bank](#) which has not been drawn upon, and is renewed annually.

Leverage: Good Debt Affordability with No Major Debt Increases Planned

Point Loma Nazarene University's debt burden relative to operations is low allowing it strong financial flexibility. In FY 2016, debt service represented a manageable 3% of operating expenses in FY 2016. Debt affordability is good, with a FY 2016 debt to cash flow of 2.9 times. Debt burden relative to balance sheet wealth is weaker with spendable cash to debt of 1.3 times, but is expected to improve in the next few years given the university's consistently solid cash flow generation, and no new debt plans or major capital needs on the horizon.

DEBT STRUCTURE

PNLU has concentrated bank exposure, with all of its debt held as private placements as well as a line of credit with First Republic Bank. This bank exposure is mitigated by very strong headroom to covenants and limited put risk due to the long-term nature of the private placements. The university's Series 2014 loan is comprised of a fixed rate loan (\$19.9 million) and a variable rate loan (\$28.1 million). The financial covenants include maintenance of debt service coverage ratio of 1.15 times (FY 2016: 4.7 times) and a liquidity ratio of 0.33 times (FY 2016: 1.3 times). A breach of either covenant, as well as non-payment of principal and interest is an event of default. The variable rate loan reaches maturity on October 1, 2033, while the fixed rate matures on April 30, 2044. Moody's does not rate these loans.

The university also utilizes operating leases for some of its satellite locations, which totaled \$4.5 million in FY 2016 by Moody's calculation.

DEBT RELATED DERIVATIVES

The university maintains a LIBOR-based swap agreement with [Bank of America](#) to hedge the Series 2014 variable rate loan. Under the agreement, Bank of America has the right to terminate the agreement under certain conditions including the university's rating falling to below investment grade. PLNU is not required to post collateral at the Baa1 rating. As of December 30, 2016, the mark-to-market valuation for the swap was approximately negative \$6.1 million to the university.

PENSIONS AND OPEB

Point Loma Nazarene University has a defined contribution plan eligible to full-time employees. In FY 2016, the pension related expenses were \$2.3 million, a modest 2% of operating expenses. The university does not offer post-retirement health care coverage.

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Governance and Management: Good Strategic Positioning & Seasoned Leadership

PLNU's good strategic positioning incorporates the university's tight budgetary controls as well as continuous investment in strategic program development which has successfully translated to enrollment growth in target markets. PLNU's conservative budgeting techniques are evidenced by their consistently solid cash flow generation. The university also benefits from a seasoned management team, including a president who has served in his role for 20 years. PLNU also has a dedicated board comprised of 24 members to provide the university with strategic oversight. The board is comprised mostly of alumni with relevant business experience. Management hired an enrollment consultant in 2013 which has contributed to the university's growth.

Legal Security

The Series 2014 loan is a general obligation of the university and has a Limited Guaranty from the PLNU foundation. The loans are secured by a Deed of Trust, which includes a Security Agreement securing the university's obligations under the loan agreement with First Republic Bank.

Obligor Profile

Point Loma Nazarene University is a small private university located in San Diego, California. It is affiliated with the Church of Nazarene and has a strong health science emphasis. PLNU enrolled 3,395 FTE students in fall 2016, and generated \$102 million in operating revenue for fiscal 2016.

Methodology

The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Rating Methodologies page on www.moody's.com for a copy of this methodology.

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