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Contacts

Daniel Simpson +1.312.706.9965
Analyst
dan.simpson@moodys.com

Patrick McCabe +1.212.553.4506
Associate Lead Analyst
patrick.mccabe@moodys.com

Adebola Kushimo +1.214.979.6847
VP-Senior Analyst
adebola.kushimo@moodys.com

North Iowa Area Community College

Update to Credit Analysis

Summary

North Iowa Area Community College, IA (general obligation unlimited tax (GOULT) Aa2 stable, revenue A3 stable) is a mid-sized community college located in north central Iowa. The college's primary credit strengths include a large and stable tax base, stable financial operations with strong operating reserves relative to its operating budget and modest debt and pension burdens. The college's primary credit challenges include its weak enrollment trend and moderate reliance on state aid that exposes the college to revenue loss should fiscal pressure develop at the state level.

Credit strengths

» Large and stable tax base

» Flexibility to increase tuition and fees, both key sources of operating revenues

» Stable financial operations evidenced by the long-term maintenance of strong operating reserves relative to operating budget

» Very strong operating reserve, with spendable cash & investments to operating expenses of 1.32x (revenue rating)

» Continuing stable and positive operating performance with a three-year average operating margin of 4.6% (revenue rating)

Credit challenges

» Moderate reliance on state aid exposes the college to future revenue reductions should fiscal pressure arise at the state level

» Declines in total credit hours that have thus far been have been offset by upward adjustments in tuition rates

» Continued inability to cover housing system debt service with net system revenues due to lower than expected occupancy rates in campus housing (revenue rating)

Rating outlook

The stable outlook on the GOULT rating reflects the likelihood that continued tax base expansion and healthy finances will contribute to maintenance of a strong credit profile. For the revenue bonds, the outlook incorporates continued healthy operating performance with surplus funds available to make up any deficiency in debt service coverage for the housing system.

Factors that could lead to an upgrade

» Continued expansion of the college's tax base and strengthening of resident income indices

» Considerable growth in the college's financial position and available liquidity

Factors that could lead to a downgrade

» Narrowing of operating reserves relative to budget and/or available liquidity

» Sustained tax base contraction and/or weakening of resident income and wealth indices

» Ongoing inability to generate housing system revenues sufficient to cover debt service and reduced funds available to transfer to meet the covenanted 1.1x debt service coverage (revenue rating)

Key indicators

Exhibit 1

North Iowa Area Community College, IA	2013	2014	2015	2016	2017
Economy/Tax Base					
Total Full Value ($000)	$12,950,317	$13,273,017	$13,421,462	$13,671,393	$13,988,981
Population	109,256	109,256	109,256	109,256	109,256
Full Value Per Capita	118,532	121,485	122,844	125,132	128,039
Median Family Income (% of US Median)	95.1%	95.0%	95.4%	96.1%	95.5%
Finances					
Operating Revenue ($000)	$35,128	$36,422	$37,560	$40,185	$45,064
Fund Balance ($000)	$32,445	$33,349	$28,524	$32,245	$34,223
Cash Balance ($000)	$35,482	$38,984	$28,781	$31,588	$34,837
Fund Balance as a % of Revenues	92.4%	91.6%	75.9%	80.2%	75.9%
Cash Balance as a % of Revenues	101.0%	107.0%	76.6%	78.6%	77.3%
Debt/Pensions					
Net Direct Debt ($000)	$9,635	$34,060	$32,460	$34,120	$35,300
3-Year Average of Moody's ANPL ($000)	$14,854	$16,697	$18,784	$18,079	$18,521
Net Direct Debt / Operating Revenues (x)	0.3x	0.9x	0.9x	0.8x	0.8x
Net Direct Debt / Full Value (%)	0.1%	0.3%	0.2%	0.2%	0.3%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	0.4x	0.5x	0.5x	0.4x	0.4x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	0.1%	0.1%	0.1%	0.1%	0.1%

The data in the table above reflects fiscal year-end data through fiscal 2017.
Source: College's Audited Financial Statements and Moody's Investors Service, Inc.

Profile

North Iowa Area Community College is a mid-sized community college serving approximately 2,900 full time equivalent in fall 2017, across a multicounty area. Its main campus is located in Mason City (Aa2) and the college also operates community education centers in several cities.

Detailed credit considerations

Economy and tax base: large and stable tax base located in northern Iowa

The college's economy is expected to exhibit long-term stability due to its large service area that includes the Mason City metropolitan region. The college serves seven counties in north-central Iowa with a main campus located in Mason City (Aa2), which serves as a regional economic center for northern Iowa (Aaa stable) and southern Minnesota (Aa1 stable). The college's tax base continues to exhibit solid growth, with an average annual increase over the last five years of 4.5% to $14 billion in 2017 tax year.

Resident incomes for Cerro Gordo County (Aa2), the county with the largest presence within the college's service area, trends below nationwide figures with the median family income at 96% of the nation per the 2016 American Community Survey. The county's 3.2% unemployment rate as of February 2018 is slightly below the state's figure of 3.5%, but well below the national rate of 4.4%, over that same period.

Financial operations and reserves: stable financial profile supported by strong reserves

The college's financial operations should remain stable given a history of operating surpluses and supported by flexibility to raise tuition. The college closed fiscal 2017 on June 30, 2017, with an operating surplus of $2.8 million largely due to better than budgeted enrollment numbers and an increase in tuition that was instituted in the fall of 2016. The college's fiscal 2017 net current assets across all funds totaled $34.2 or 76% of operating revenues. For fiscal 2018, management is projecting a modest increase in reserves from greater than budgeted enrollment.

The college foundation, which held cash and investments of $29.2 million in fiscal 2017, initiated a campaign in fall 2014 with a goal of $15 million to support construction of various buildings and repairs to several buildings on campus. The college reports pledges of $13.5 million to date. Pledges are expected to be received through fiscal 2021. The college's healthy cash position will allow it to provide approximately $9 million in bridge financing for the construction of a Science, Technology, Math, and Engineering center before all campaign funds have been collected. The college will spend a portion of available reserves in its plant fund (available balance of $5.5 million in fiscal 2017) and unrestricted cash at the foundation (approximately $3.7 million available in fiscal 2017). The college's ability to maintain its healthy financial position despite the planned temporary use of reserves will be key to future rating reviews.

Total full-time equivalent (FTE) declined from 2,902 in fiscal 2016 to 2,784 in fiscal 2017. The college's long-term enrollment trend is weak with FTE enrollment down from 3,363 in fiscal 2012. The decline in the college's FTEs is largely due to the counter cyclical relationship between enrollment and labor market trends. Management has broad flexibility to raise tuition and has demonstrated its willingness to increase tuition to offset downward pressure on revenue due to declining credit hour enrollment. Mirroring the college's enrollment trend, the college reported a housing occupancy rate of 89% in fiscal 2017, which is below the college's projections.

LIQUIDITY

The college's cash position is healthy. At the close of fiscal 2017, the college's net cash balance across all governmental funds was $34.8 million, or 77% of revenues. Additionally, the college foundation reported a cash and investment balance of $29.2 million in fiscal 2017.

Debt and pensions: modest debt and pension burden

The college's debt burden is expected to remain modest given the lack of significant additional debt plans and continued tax base and revenue growth. The college's net direct debt burden, including the Series 2018-1 certificates, totals total $35.5 million or 0.3% of full value and 0.9x fiscal 2017 operating revenues. The net direct figure above includes $24.6 million of dormitory revenue debt (A3 stable) bonds that are first secured by net revenues of the college's housing system. Fiscal 2017 net revenues of the college's dormitory system were insufficient to cover debt service and required a transfer of $700,000, or 1.5% of operating revenues, from the college's general operating revenues to cover debt service on the outstanding dormitory revenue bonds. Because dormitory revenue alone has not routinely been sufficient to meet annual debt service requirements, the dorm revenue bonds are included in the debt burden assessment. Total GOULT and revenue debt service totaled $3.3 million, or 7.4% of fiscal 2017 operating expenses.

Currently, pensions are not a significant credit pressure for the college. The college’s three year average Moody’s Adjusted Net Pension Liability (ANPL), which incorporates adjustments we make to reported pension data, amounted to $21 million, or a modest 0.7x fiscal 2017 operating revenues and 0.2% of full value.

Total fixed costs, inclusive of debt and pension contributions, totaled $3.9 million, or 9.5% of fiscal 2017 operating revenues.

DEBT STRUCTURE

All of the college's debt is fixed rate and amortization of GOULT debt is rapid with 100% of outstanding principal retired within 10 years.

DEBT-RELATED DERIVATIVES

The college is not a party to any debt-related derivatives agreements.

PENSIONS AND OPEB

The college participates in a defined benefit multiple-employer cost-sharing plans, the Iowa Public Employees' Retirement System (IPERS). On an annual basis, the plan establishes local government retirement contributions as a share of annual payroll based on actuarial requirements. The college's fiscal 2017 contribution to IPERS was $666,000 or a modest 2.1% of operating revenues

In aggregate, all participating governments contributions were 96% of the "tread water" indicator in fiscal 2016. The "tread water" indicator is the annual employer contribution required to prevent unfunded liabilities from growing if plan assumptions hold.

Other post-employment benefits (OPEB) obligations do not represent a material credit risk for the college. The city does not offer explicit OPEB benefits, but allows retired employees to stay on its health care plan, creating an implicit rate subsidy. The college made a $317,000 pay-as-you-go contribution to the plan, equal to 1% of operating revenues. As of July 1, 2014, the most recent actuarial valuation date, the plan had a unfunded actuarial accrued liability (UAAL) of just under $6.6 million.

Management and governance: high institutional framework

Iowa community college districts have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. The sector has one or more major revenue sources that are not subject to any caps. Revenues tend to be predictable. Across the sector, fixed and mandated costs are moderate. However, Iowa has public sector unions, which can limit the ability to cut expenditures. Expenditures mostly consist of personnel costs, which are highly predictable.

The college's very good strategic positioning is supported by the management team's ongoing assessments of their programmatic offerings to align with the demands of the service area and job training partners. The college's financial management strategy continues to produce positive operating and cash flow margins despite a period of declining enrollment.

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