FitchRatings

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Fitch Rates Grand Canyon University, AZ's IDR and Revs 'BBB-'; Outlook Stable

Fitch Ratings - New York - 17 Jun 2024: Fitch Ratings has assigned a 'BBB-' Issuer Default Rating (IDR) to Grand Canyon University, AZ (GCU). The Rating Outlook is Stable. Fitch has also assigned a 'BBB-' rating to GCU's $1.2 billion series 2021B taxable bonds and up to $520 million taxable bonds, series 2024A. The series 2024A taxable bonds are expected to be sold via private placement in the summer of 2024, and will refinance portions of the series 2021B bonds.

The 'BBB-' IDR and bond ratings for GCU are based on its competitive strengths in both the traditional and online higher education markets, and an operating model that provides strong cash flows and high flexibility. These credit strengths are tempered by GCU's very high leverage with additional risks from its debt structure.

The Outlook is Stable, although GCU is involved in ongoing regulatory and legal matters that have received significant publicity. The university is currently in compliance with the terms of its regulatory requirements and agreements and has the capacity to manage currently proposed fines while the university seeks appeals or dismissals. GCU has also reported to Fitch that it is at least partially indemnified against other known pending claims and suits. Nevertheless, a large unappealable judgment against the university could pressure the ratings.

SECURITY

The series 2024A bonds are expected to be secured, together with any outstanding series 2021B bonds and a $69 million term loan with a bank, under a Master Trust Indenture (MTI). The MTI provides for GCU's gross revenues to be pledged and held pursuant to a deposit account control agreement, and a mortgage on GCU's 300-acre campus property in Phoenix, AZ appraised at over $2 billion in 2023. GCU also maintains a $50 million undrawn line of credit under the MTI. There is no debt service reserve fund securing instruments issued under the MTI.

Outside of the MTI, GCU maintains two bank lines of credit with a capacity of $100 million and outstanding amount of $80 million as of June 30, 2023. Outstanding amounts under the lines of credit are fully collateralized, totaling $84 million cash and investments at FYE 2023.

KEY RATING DRIVERS

Revenue Defensibility - 'a'

GCU has a significant and growing presence in both the traditional and online higher education markets, with about 25,000 undergraduates studying at its main campus in Phoenix, AZ, and more than 90,000 students from all 50 U.S. states enrolled in its online undergraduate and graduate programs.

In the traditional ground program, GCU benefits from its competitive position as a low-cost, Christian private university in a favorable demographic region and climate. GCU's growth and presence in the online education market reflects its national brand recognition and ability to quickly adapt and tailor programs to meet workforce development needs and student demand.

Operating Risk - 'aa'

GCU's track record of strong cash flows are poised to remain strong even if revenues are volatile. This is due to an operating model that outsources most non-educational and non-management functions to the currently unaffiliated Grand Canyon Education (GCE) in exchange for a fixed percentage of revenues. Through this operating model, GCU has a flexible expense base that automatically scales up or down in line with revenues. However, its business model also limits its ability to benefit from economies of scale as operations grow.

Fitch believes that GCU has significant capital expenditure flexibility after a period of significant capex spending.

Financial Profile - 'bbb'

GCU's solid revenue defensibility and strong operating risk characteristics are tempered by the university's very high leverage that features large balloon payments on its bonded debt or bank loans, exposing the university to refinancing risks. However, the series 2024 bonds and sinking funds will refinance the near-term, $550 million, October 1, 2024 maturity of the series 2021B bonds.

Furthermore, GCU's leverage is effectively weakened by cash held by banks as collateral against some outstanding bank debt.

Asymmetric Additional Risk Considerations

GCU is subject to class-action litigation over marketing practices and a suit filed by the U.S. Federal Trade Commission in December 2023. While litigation outcomes are uncertain and GCU is contesting these claims, any significant adverse rulings against the university could affect its financial profile and ratings.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

--Erosion of Fitch-calculated cash flow margins to below about 10% resulting from expense growth or contraction that tracks unfavorably against revenues, or to levels insufficient to meet annual debt service needs;

--Increased use of cash towards collateralized bank lines or notes, effectively reducing funds available to pay debt service on MTI obligations;

--Inability to refinance maturing bank loans or bullet maturities on bonds on manageable terms;

--Diminished cash and Available Funds-to-Debt below 40% without adjusting for bank-held cash collateral, or below about 30% after adjusting for bank-held cash collateral, in Fitch-modeled forward looking scenarios;

--Sizeable internally-funded or debt-funded capital expenditures beyond current expectations of approximately 100% of depreciation expense over the next several years;

--Performance failures by GCE in the Master Services Agreement (MSA), or termination of the MSA without internal or alternate sources to replace the services GCE provides in the MSA.

--Unappealable final judgements against GCU that result in substantial impact on the university's financial profile, or noncompliance with significant U.S. Department of Education (DOE) regulations, standards and agreements applicable to GCU as a DOE-designated for-profit institution.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

--Fitch-calculated cash flow margins regularly approaching 15% or more, resulting in robust debt service coverage and increasing balance sheet resources;

--Decreased use or elimination of cash used for collateral against outstanding portions of bank lines;

--Replacement of current lumpy debt service obligations with more level debt service to reduce refinancing risks, and reduction of shorter-term bank notes and collateralized lines to fund capital expenditures.

PROFILE

Grand Canyon University is a coeducational, Christian university with two primary modalities. Its traditional undergraduate residential program is based on a 300-acre campus in Phoenix, AZ with approximately 25,000 students as of fall 2023. GCU participates in 21 NCAA Division I sports programs and engages in ministry projects in its surrounding community in Phoenix. Its online and hybrid programs enroll approximately 93,000 undergraduate, graduate and certificate students from all 50 U.S. states.

GCU offers hybrid Accelerated Bachelor's of Science in Nursing Programs in Arizona, Utah, Nevada and Wyoming in spaces provided by GCE. GCU also launched its Center for Workforce Development in Phoenix in partnership with local employers where it offers pre-apprenticeship programs for high demand skilled trade roles such as electricians and computer numerical control machinists.

GCU traces its roots to 1949, when Grand Canyon College was established in Arizona as a Baptist-affiliated institution focusing on religious studies and education degrees. In 2004, investors purchased the university and expanded its online programs as a for-profit institution, and completed an initial public offering in 2008 as GCE. In 2014 the non-profit Gazelle University was formed and in 2018, changed its name to Grand Canyon University and purchased the academic operations, other business operations, and real estate and improvements of the university from GCE.

As part of this transaction, GCU issued a $1.1 billion note to GCE, which was since refinanced with $1.2 billion in series 2021B bonds. In addition, GCU entered into a Master Services Agreement (MSE) with GCE, whereby GCE provides certain technological, counseling, marketing, financial aid processing and other administrative functions to GCU in exchange for 60% of GCU's net student revenues.

GCU is accredited by the Higher Learning Commission (HLC) under heightened monitoring status and with a governmental investigation designation due to the DOE's investigation and recent suit filed by the U.S. Federal Trade Commission. GCU's most recent event with HLC was the March 7, 2024 acceptance of GCU's interim monitoring report. HLC most recently affirmed GCU's accreditation in 2020-2021 and is scheduled for its next comprehensive evaluation in 2026-2027.

GCU's Board of Trustees consists of five independent members who were elected in 2018. GCU President Brian Meuller, who is not a GCU Trustee, is CEO and Board Chair of GCE. To reduce perceived or actual conflicts of interest arising from his roles at both GCU and GCE, President Meuller cannot serve on GCU's master services agreement committee.

Regulatory and Legal Matters

As part of the university's transition to non-profit status in in 2018, GCU sought non-profit recognition from the IRS, the State of Arizona, its regional accreditor Higher Learning Commission (HLC), and the U.S. DOE. All entities except the DOE currently recognize GCU as a non-profit. DOE cited the fees and some conditions of the MSA with GCE as a reason for their position.

GCU management claims no material operational or marketing impacts from the DOE for-profit status. However, as a for-profit institution for DOE purposes, GCU is subject to additional DOE oversight, regulations and conditions to participate in federal financial aid programs. GCU is currently in compliance with these DOE for-profit conditions. GCU sued the DOE over its decision not to grant not-for-profit status to GCU in federal district court, which was decided in favor of the DOE. GCU filed an appeal in January 2023.

GCU has been authorized to participate in federal student aid programs through successive provisional program participation agreements (PPPA) with DOE. The current PPPA was last executed in September 2023 and expires in June 2026. Under the terms of the current PPPA, GCU has five new monitoring and disclosure requirements pertaining to marketing practices. GCU reports that it is in compliance with all new conditions of the current PPPA.

The DOE also recommended a $37.7 million fine against GCU in October 2023 related to DOE allegations that disclosure documents for certain doctoral programs are misleading. The DOE must pursue those allegations through an administrative hearing process before it can impose the fine. GCU denies the DOE's characterizations and is defending against the fine.

GCU and GCE are jointly named in a private suit that has been granted class-action status related to an allegation of misleading accreditation claims for a certain master's program, and another suit regarding alleged incentive compensation paid to GCE enrollment counselors. According to GCU management, the university is indemnified by GCE in both matters. GCU is also currently defending an action brought by the FTC against the University, President Mueller, and GCE alleging specific misrepresentations and abusive telemarketing calls by GCE. In June 2024, two students filed a class action claim against GCE, with similar allegations as those made by the DOE and FTC about marketing of certain doctoral programs. GCU is not named in this lawsuit.

GCU is also undergoing an IRS audit of its 990 tax filings for non-profit organizations for fiscal years 2015-2019.

The likely outcomes of these suits, appeals, and regulatory matters cannot be assessed at this time. GCU has not placed any funds in reserve related to any suits or fines.

Date of Relevant Committee

07-Jun-2024

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

GSU has an ESG Relevance Score of '4' for Governance Structure, defined as board independence and effectiveness in fiduciary and strategic efforts, ownership concentration and span of control, and Group Structure defined as complexity, transparency and related-party transactions. The elevated scores arise from the interdependence of GCU with GCE, the shared senior executive at both entities, and limited breadth of GCU's board with five total Trustees with almost unanimous consent (two-thirds of Trustees, currently four of the five Trustees) required to replace its president. This has a negative impact on the credit profile and is relevant to the rating in conjunction with other factors.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Grand Canyon University (AZ)	LT IDR	BBB-	New Rating		
• Grand Canyon University (AZ) /General Revenues/ 1 LT	LT	BBB-	New Rating		

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		

RATINGS KEY OUTLOOK WATCH

STABLE ⭘

Applicable Criteria

U.S. Public Finance College and University Rating Criteria (pub.19 Sep 2023) (including rating assumption sensitivity)

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub.12 Jan 2024) (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), v2.0.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

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