The Chapman University Story

Strategic Planning for Private Institutions

Increased competition among private colleges and universities has driven many to take proactive measures to ensure their long-term viability. One such example is Chapman University (Chapman or the University), which has paved the way for small-to-mid-size, liberal arts institutions to strengthen their competitive differentiation while maintaining financial health. With the use of PFM's Whitebirch, Chapman is able to effectively evaluate the ongoing impacts of strategic planning, ensuring capital and operating decisions fit within the University's financial guidelines.

Evaluating Financial Drivers with Whitebirch

As Harold W. Hewitt Jr., Executive Vice President and Chief Operating Officer, explains, multi-year planning is essential for the financial health of the higher education industry. He argues that institutions "cannot make one year decisions without understanding the trajectory of their future impact." Setting tuition rates is a prime example of this, and it is particularly important for private institutions. As Hewitt describes, one of the best features of Whitebirch is that it enables institutions to make a "complex modeling activity out of tuition pricing." He explains that various undergraduate classes are impacted by tuition rates uniquely, so a continuing student will feel the effects of a five percent raise in tuition differently than a newly-recruited incoming student. Whitebirch allows users to assign unique enrollment consequences to upper classes and incoming freshman based on a tuition price level increase.

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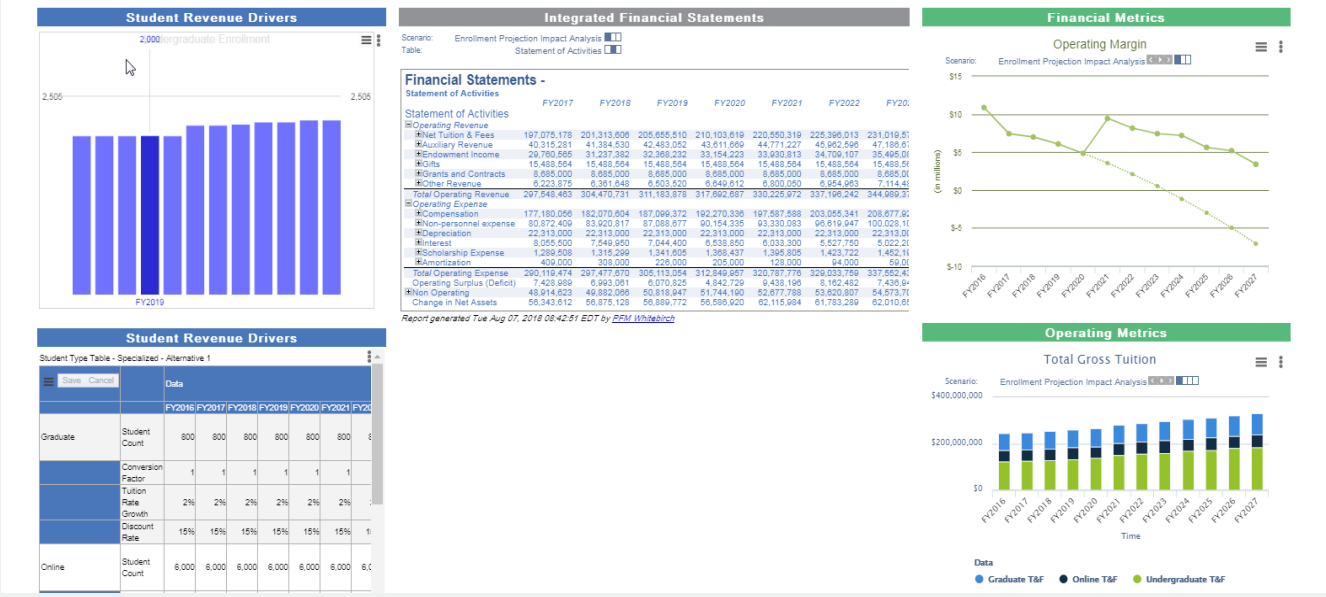
ANAZLYING STUDENT REVENUE ASSUMPTIONS



Setting tuition rates is one of many major variables Chapman considers during their annual planning cycle. In determining which key assumptions should be included in the long-term projections for the University's budget, Hewitt explains that it is a collaborative process, with input from the Board of Trustees (Board). Beginning in 2008, Hewitt and his team consulted the perspective of the Finance Committee, which is composed of numerous business leaders with a depth of experience. Based on those discussions, Chapman developed a system for including Board and senior management decisions on the driving factors of the model, and this same process has been used for the past nine years. As Hewitt explains, one of the primary key assumptions is undergraduate enrollment, including first year admissions, which is particularly important given that Chapman is a private institution dependent on tuition.

The University also tracks data on graduate students, discount rate projections, endowment spending rates, assumptions concerning cost/push variables and salary increases. Assumptions from previous years are analyzed at the beginning of the annual budget planning process, and Chapman's leadership evaluates the current year's proposed variables at this time.

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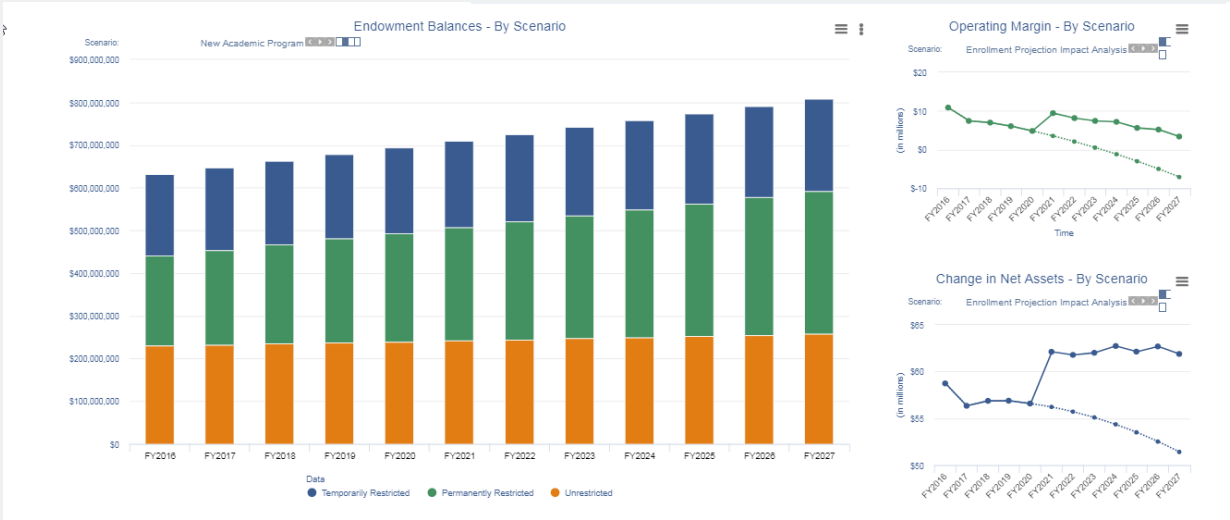
Planning for Targeted Endowment Growth

For Hewitt, Whitebirch is a "perfect match for the unique business style of the University." Chapman uses the platform to identify board-determined financial cornerstones and model five to 10 years out, to ensure that recommendations for future projects fit within overall financial guidelines and targets. This includes

MODELING ENDOWMENT GROWTH



strategic planning, annual budget decisions or off-budget cycle mission-critical requirements. As an example of the sophisticated financial modeling Chapman relies on Whitebirch for, Hewitt explains the University's process for redistributing funds. On an annual basis, a certain amount of net from Chapman's operations is reinvested in a fund used to cover major repair and renewal, which is separate from the amount committed from the unrestricted operating budget to address deferred maintenance. Another portion of the net from operations is assigned annually to increase the size of the endowment. As Hewitt argues, "These are selected targets, not accidents," supported by the model. As a testament to the success of this strategy, Chapman has been able to grow the total size of the market value of their endowment from $134 million to $392 million, as of FY 2018, over the last 10 years. A primary benefit of the University's method for growing the endowment is the creation of highly liquid quasi-endowment funds. Hewitt explains, "We have been able to take our endowment from roughly eight percent true, or restricted and inaccessible, and we have flipped that ratio to about 50 percent liquid." For Chapman as a whole, this has major benefits. The University's liquidity is a significant advantage when receiving credit evaluations during municipal bond issuance. Chapman's liquidity has also grown over the past decade, which Hewitt describes as "highly anomalous in the industry." As he reiterates, "This is all intentional and part of the business model and business planning of Chapman." The other benefit of this enhanced liquidity is that it builds a readily accessible portfolio of cash when the University needs it, such as during times of emergency. Lastly, the annual investments in the endowment have generated greater amounts of spending, and the unrestricted portion of the fund goes toward supporting need-based financial aid and University-funded grants. For Hewitt, "It's the rigor of the model that has enabled us to set these targets, track our progress, meet the goals, and to readily report them back to the Board." He continues, "These financial targets that we use to guide all sorts of decision-making at Chapman – including budget, strategic plan, and near-term mission-based off budget plan goals and investment decisions – we don't do anything without modeling it through Whitebirch." This helps ensure the University is adhering to its overall financial guidelines and targets.

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Modeling New and Existing Program Offerings

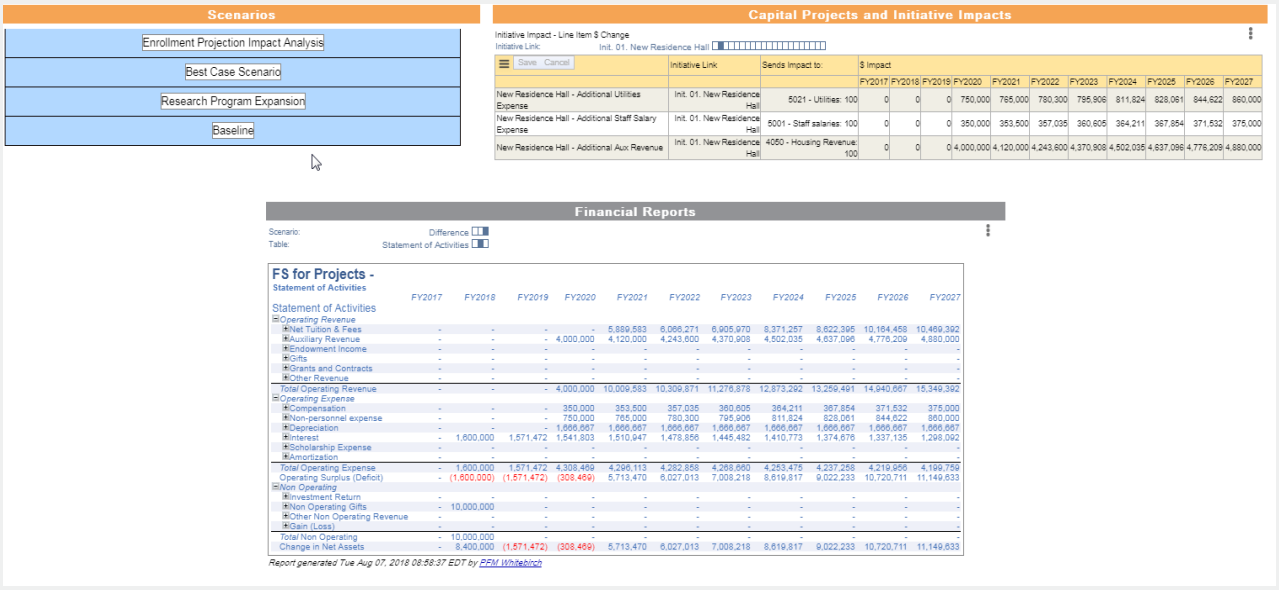
Chapman also uses Whitebirch to evaluate the financial feasibility of new program offerings, as the University is in the unusual position of growing academic programs rather than capping them. As an example, Chapman recently added a PhD program in communication studies, which was a predetermined component of their current strategic plan. One of

the University's goals is to achieve national ranking under the Carnegie Classifications for Higher Education Institutions, and a requirement under this framework is a minimum number of research PhDs granted. As Hewitt explains, Chapman's leadership is focused on developing research PhD programs that are mission-appropriate, but this is an extremely selective and careful process that includes meeting a stringent financial test. This is in part due to the fact that PhD programs are often costly for higher education institutions – universities with competitive programs typically cover tuition and provide a stipend to students. For Chapman, this often means that these programs will "run negative," and the challenge is figuring out how negative. As a result, having access to a financial model that accurately determines future consequences is critical. In the University's use of Whitebirch, Hewitt explains, guidelines are established to ensure that only a certain number of "red-ink" programs are added in order to balance the overall financial operation, including targeted reinvestments in the endowment fund. As Hewitt argues, "It takes a complex, integrated, rigorous modeling tool like Whitebirch to be able to integrate all of these assumptions and plans, and assure all of us that adding the program will be consistent with the overall financial goals of Chapman."

Balancing Strategic Planning Initiatives

The addition of major programs typically coincides with capital expansion, and Whitebirch helps ensure the University avoids the financial uncertainty of adding new facilities. Hewitt provides the example of Marion Knott Studios, part of the Dodge College of Film and Media Arts. This facility was opened in 2006, and it immediately caused Chapman's enrollment in the film program to accelerate, leading to the school's soaring international ranking. The program is highly in-demand largely because the facility is state-of-the-art – it is equipped with television studies, film production stages and an integrated, centralized facility for editing raw materials. For Hewitt, this project is a good example of how capital planning at Chapman supports the overall mission. The University's business model centers on creating major new programs to drive growth, sustaining

EVALUATING THE LONG-TERM IMPACTS OF CAPITAL PROJECTS



their financial capacity and providing them with the investment funds to move onto the next program. Hewitt provides a more recent example to further emphasize this point – the establishment of the Rinker Health Science Campus, a satellite campus in Irvine, CA. This facility houses Chapman's new pharmacy school, which Hewitt describes as a "state-of-the-art facility with all the competitive advantages," much like Marion Knott Studies and the film school. Likewise, the University utilizes the capital model – the facility – as a competitive advantage in the recruitment of new students.

Hewitt explains that in his opinion, the best feature of Whitebirch is its "integration of what you're doing on the capital side with what you're doing on the operating side – seamlessly and effortlessly." Therefore, it enables institutions to evaluate different options for capital construction.

Hewitt continues, "You can overspend on capital projects, but without sophisticated modeling tools, you don't know to what degree you're overspending and how to fix it." Hewitt relies on Whitebirch, along with the University's planning and design group, to evaluate "projections of different interpretations of the buildings and facilities, right on down to furniture and equipment, which are necessary to create the next great school." The model accomplishes "every aspect of capital planning perfectly," argues Hewitt, and when Chapman is ready to build a new project, it is as simple as "loading it into Whitebirch, where the model automatically calculates depreciation and shows the impact on both the balance sheet and operating budget over time." As a result, Chapman is able to evaluate the impact of capital decisions over the entire planning horizon, not just the year in which the University is planning on adding the building. For Hewitt, Whitebirch does this "seamlessly and instantly," instead of having to "combine one hundred different spreadsheets."

For Chapman, maintaining a business model of expansion without compromising financial stability requires the use of multi-year planning software. With the assistance of Whitebirch, the University continues to define itself as a leader in the industry, avoiding the pitfalls of growth that befall similar institutions.

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