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June 11, 2009

Oregon Facilities Authority Reed College, Oregon; Private Coll/Univ - General Obligation

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Oregon Facilities Authority
Reed College, Oregon; Private Coll/Univ - General Obligation

Credit Profile		
Oregon Fac Auth, Oregon		
Reed Coll, Oregon		
Oregon Fac Auth (Reed College) ser 1995A 2000A		
Long Term Rating	AA-/Positive	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA-/A-1+' and 'AA-' ratings on the Oregon Facilities Authority's debt issued for Reed College. The short-term component of the rating reflects a standby bond purchase agreement provided by Wells Fargo Bank National Association (AAA/A-1+). The outlook remains positive.

Long-term rating factors include our view of the college's:

- Good financial resources, with unrestricted resources nearly 4x annual operating expenses and 5x debt at June 30, 2008;
- Modest growth in applications in fall 2008 (3.6%), and a 32% acceptance rate -- an improvement from 70% six years ago;
- Moderate debt burden of just under 5% of expenses; and
- A good history of fundraising, with annual giving of more than $3 million in 2008 and an alumni participation rate of just more than 30%.

The long-term rating is offset by our view of the college's:

- High reliance on investment returns for operating performance, with uncertain markets and historically aggressive portfolio mix; and
- Small enrollment and strong competition for students, which translates to relatively low matriculation rates.

Total outstanding debt is $68 million, two-thirds of which is variable-rate debt. In conjunction with the series 2006 bonds, Reed entered into a $16.65 million floating-to-fixed swap contract with UBS (A+) as counterparty. We view the swap as a moderate risk. All bonds are a general obligation of the college. Debt service for the college is level, with maximum annual debt service of $4.2 million.

Outlook

The positive outlook reflects our expectation that Reed College will remain competitive and continue to improve its operational results on a full accrual basis. Additionally, we anticipate that the college will be able to manage through the decline in endowment operating moneys in the next three or more years while maintaining the institution's mission.

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The College

Founded in 1908, Reed College is a liberal-arts institution that attracts high-quality students from throughout the country. Reed shares student cross-applications and admissions with institutions such as University of Chicago, Ill.; Brown University, R.I.; Oberlin College, Ohio; Swarthmore College, Pa.; Pomona College, Calif.; and Wesleyan University, Conn. Despite strong competition from these and other schools, Reed has maintained relatively stable enrollment trends during the past three years, with a headcount totaling 1,471 for fall 2008. Management feels that the school's enrollment is currently larger than its optimum level and is trying to reduce its size to about 1,250 undergraduates; currently there are 1,442 students.

Demand

Demand for the college continues to grow. Reed received 3,485 applications for fall 2008, a 3.6% increase from the previous year and a good 40% increase from five years ago. Applications are up for fall 2009 as well. Management attributes the rise in applications to enhanced marketing and an increase in campus visits from prospective students. With the reduction of the student body and increased applications, acceptance rates have improved to 33.5% for fall 2008, compared with 70% for fall 2001. However, matriculation rates have remained stable at around 30%, indicating continued strong competition for top students. Although the college hopes to decrease its overall size in the future, it will enroll slightly more first-year students in fall 2009. Reed attracts students from throughout the nation, with more than 80% of the student body originating from out of state. The retention rate is in our view very good at around 90%. Tuition was $37,960 for the 2008-2009 school year; it will be raised 3.9% for fall 2009, according to management. The overall tuition discount rate was 33% in fiscal 2008. In fiscal 2009, management estimates overall tuition discount rate to be 32%, with the first-year tuition discount estimated to be 34% for fall 2009.

Operations

We believe Reed's budget is highly reliant on endowment-generated revenue, with endowment spending accounting for over a quarter of the fiscal 2009 budget or about $16.5 million. The endowment was $464.5 million at fiscal year-end (down just 1% from the previous year); however, it decreased to $325.6 million at the end of April 2009. Because the college has an annual spending rate of 5.3% on a rolling 13-quarter average, the college is carefully planning on reducing the dollar amount that will be available in 2011 and later years.

The college, on a budgetary basis, was able to achieve modest surpluses in fiscals 2007 and 2008. Management expects operational performance to be break-even in fiscal 2009. In the calculation of operating performance, we traditionally deduct the effects of unrealized/realized gains and losses. However, as Reed accounts for a significant portion of its annual endowment spending in the gains/losses line, we included that portion ($11.4 million in 2008 and $10.8 million in fiscal 2007) in the calculation of operating performance. With this adjustment, the college had an operating surplus of $1.7 million in fiscal 2008 on a full accrual basis and deficits of $4.1 million in fiscal 2007 and $1.1 million in fiscal 2006. Without this adjustment, the college had deficits of $9.7 million in fiscal 2008, $14.9 million in fiscal 2007, and $10.5 million in fiscal 2006.

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Debt/Financial Resources

Reed's financial resources had been improving before the market downturn. At the end of the fiscal year, they were in our opinion still good for the rating category, with unrestricted resources of $341 million covering expenses by nearly 4x and debt by 5x. Cash and investments are in our view even stronger at $481 million, and covered Reed's debt of $68 million by more than 7x. Debt service is in our opinion manageable, at just under 5% of adjusted operating expenses. We understand that the college has no debt plans within the outlook period of two years.

Fundraising/Endowment

Fundraising is strong at the college, with annual fund donations of $3 million in fiscal 2008. However, giving is down about 10% from this time last year. The last capital campaign ended in 2000 and raised $113 million, well above the goal of $80 million. There is a new campaign underway, and $130 million of the $200 million goal has been raised. Reed's endowment declined significantly to $325.6 million as of April 30, 2009 (40%), or $228,000 per full-time-equivalent student. Target asset allocation has been diversifying and is in our view somewhat aggressive, with a target of 40% in absolute return (32% as of April 30, 2009), 25% in equities (currently 11%), 18% in real assets (currently 14%), and 15% in private equity (currently just about at target). While the target is 2% for cash, like many institutions, Reed currently has about 28% in cash or fixed-income investments.

Swap Analysis

In conjunction with the series 2006 bonds, Reed entered into a $16.65 million floating-to-fixed swap contract with UBS (A+) as counterparty. This swap is Reed's only outstanding debt derivative contract. The college has been assigned a Standard & Poor's Debt Derivative Profile (DDP) score of '2' on a four-point scale, where '1' represents the lowest risk. In our view, the swap program poses low to moderate risk to Reed's credit quality due to a structure that is well matched to the underlying debt, a highly rated counterparty, and Reed's ability to cover any collateral needs with its endowment of more than $320 million. As of March 2009, its mark-to-market was a negative $2.9 million. The college has not had to post collateral.

Contact

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Related Research

- USPF Criteria: "Higher Education," June 19, 2007
- USPF Criteria: "Debt Derivative Profile Scores," March 27, 2006

Ratings Detail (As Of June 11, 2009)		
Oregon Fac Auth, Oregon		
Reed Coll, Oregon		
Oregon Fac Auth (Reed Coll) rfdg bnds (Reed Coll) ser 2008 due 07/01/2038		
Long Term Rating	AA-/A-1+/Positive	Affirmed

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