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

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

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| **Oregon Fac Auth (Reed College), rev bnds, ser 2011 A** | | |
| *Long Term Rating* | AA-/Stable | Affirmed |

## Rationale

Standard & Poor's Ratings Services affirmed its 'AA-/A-1+' and 'AA-' ratings on the Oregon Facilities Authority's revenue bonds outstanding, issued for Reed College. The short-term component of the rating reflects a standby bond purchase agreement (SBPA) provided by Wells Fargo Bank National Association. The outlook on the long-term component of the ratings is stable. The college relies heavily on the endowment for operating support. And while the college's balanced sheet remained strong in fiscal 2013 (fiscal year-end is June 30), this was the first year of the college's three years of planned small budgetary deficits, due in part to smaller endowment draws (on a dollar basis) that reflect past investment losses . While applications decreased in fall 2013, they have rebounded for fall 2014, according to management. Reed remains in a competitive market, as evidenced by less than a third of admitted students enrolling.

The long-term component of the ratings reflects our view of the college's:

- Solid balance sheet for the rating category, with an endowment of about $526.3 million as of Dec. 31, 2013, and fiscal 2013 expendable resources equal to 3.4x of annual operating expenses and an improved 4.1x of debt, which we consider good;
- Good history of fundraising, with an alumni participation rate of slightly more than 30% and a completed (in 2012) $200 million capital campaign; and
- Good student quality, highlighted by a median SAT score of 2051 in fall 2013.

In our view, the preceding credit strengths are partly offset by:

- Strong competition, as demonstrated by only 25% of admitted students enrolling;
- The college's high reliance on investment returns for operating performance (about 22% of budget);
- The college's small deficit on a budgetary basis in fiscal 2013 (partially offset by continued positive results on an audited and adjusted operating basis), and management's expectation that operations will continue to be slightly negative on a budgetary basis for the next fiscal year; and
- The high maximum annual debt service (MADS) debt burden for the rating category, at 6.8%, although it has decreased from 7.5% in fiscal 2011.

Total debt as of June 30, 2013, was $83.7 million, slightly more than half of which was variable-rate debt (series 2008:

$44.1 million). The SBPA related to the series 2008 variable-rate demand bonds expires in April 2015. The college's debt service structure steadily escalates, to an estimated $6.9 million in 2042 from $4.4 million in 2014, a structure that in our view limits the college's flexibility to issue additional debt. The debt burden, using near-term average debt service of $4.9 million and adjusted audited operating expenses in 2013, is 4.8%; when using MADS of $6.9 million (occurring in 2048), the debt burden is 6.8%, which we consider high. We understand that the university currently has no plans to issue additional debt.

## Outlook

The stable outlook reflects our anticipation that during the next two years, the college will continue to have stable enrollment and maintain its solid financial resources ratios. In addition, we anticipate that operating deficits will not exceed management's expectations during the two-year outlook time frame.

We could take a negative rating action if enrollment declines or the college reports larger-than-anticipated operating deficits. In our opinion, a positive outlook or rating action is unlikely during the two-year outlook period due to planned budgetary deficits. However, we would view positively less of a reliance on endowment draws, and a more level debt structure.

## Enterprise Profile

### Description

Founded in 1908, Reed College is a liberal-arts institution that attracts high-quality undergraduate students from across the U.S. The median freshman SAT score was 2051 in fall 2013, which we consider strong. Reed shares student cross-applications and admissions with institutions such as Brown University, R.I., Oberlin College, Ohio, Swarthmore College, Pa., Pomona College, Calif., and Wesleyan University, Conn. Reed has maintained relatively stable enrollment, and headcount totaled 1,411 for fall 2013, although this is purposely down from 1,481 in fall 2009.

### Management

The college is governed by a self-perpetuating board of trustees that consists of up to 30 members. The college appointed a new president as of July 1, 2012, after the retirement of the previous president, who had served for more than a decade. Hence, a new strategic planning process commenced in fall 2013. Historically, the college has budgeted conservatively. The long-serving (40 years) vice president of finance and treasurer is slated to retire in May 2014. A new CFO is in place.

### Demand

Enrollment is relatively stable at about 1,411 students in fall 2013, although down from 1,481 in fall 2009. Management purposely has tried to shrink enrolment a little, and the way it counts enrollment has also changed slightly (it no longer counts students who are not on campus for the year).

After stabilizing in fall 2012, first-year applications declined in fall 2013. Management has shared, however, that applications are up 37% to date from this time last year. First-year applications for fall 2013 were down 7.6% from last year. Reed received 2,893 applications for fall 2013. As we would expect, overall selectivity also weakened, to 48.5%.

Management is intentionally trying to reduce the sizes of entering classes. The ideal entering class is about 350 students; in fall 2012 the entering class was 320, and in 2013 it was 358. The matriculation rate also dipped a bit to 25% from 28%, which we consider low for the rating category. Reed continues to compete for high-quality students both nationally and regionally.

Reed attracts students from throughout the nation, and more than 90% of students come from outside of Oregon. The first-second year retention rate is, in our view, very good and improving, at roughly 94%. Tuition is $45,750 for the 2013-2014 school year. The overall tuition discount rate was 36% in fiscal 2013, although management has shared that it focuses more on how many students receive financial aid, rather than the discount rate.

## Financial Profile

### Operations

With an endowment of $526.3 million as of December 2013, Reed's budget is highly reliant on endowment-generated revenue, in our view -- endowment spending accounted for 22% of fiscal 2013 revenues, or about $19.7 million. Because the college has an annual spending rate of 5.3% on a rolling 13-quarter average, a rate that we consider to be somewhat above average. Management has indicated that it has saved surpluses to cover anticipated small operating shortfalls. The annual spending rate was lowered to 5.25% in fiscal 2014, and management plans to continue lowering the rate by 0.05% per year until it reaches 5.0%.

The college achieved modest surpluses on a budgetary basis in fiscal years 2010 and 2011, broke even in fiscal 2012, and had a budgetary deficit of $1.8 million in fiscal 2013. Its audit includes unrealized/realized gains above the line ($37.7 million) and thus shows a $25.8 million surplus. Generally, on an audited basis, we calculate operating performance by adjusting unrealized/realized gains and losses in investments. However, as Reed accounts for a significant portion of its annual endowment spending in the gains/losses line, we historically have included a portion in the calculation of operating performance. With this adjustment, the college had an operating surplus of only $385,000 in fiscal 2013. Further, management has budgeted another operating deficit of roughly $1.7 million for fiscal 2014. The college is budgeting to return to break even in fiscal 2015. The deficits are in part due to lower endowment draws for operations and to increased health care and retired medical costs, according to management.

### Financial resources

At June 30, 2013, Reed's financial resources ratios were improved from the previous year and remain good for the rating category, in our opinion, with expendable resources of $346 million equal to 3.4x of expenses and 4.1x debt. Cash and investments (which include restricted endowment) are even stronger, at $533 million, equal to 6.3x debt.

Fundraising is strong at the college, in our view: Annual fund donations totaled more than $3 million in fiscal 2013, and the goals are planned to incrementally increase annually. The college finished a $200 million capital campaign in 2012. Reed's endowment stood at $480.4 million as of June 30, 2013, and $526.3 million as of Dec. 31, 2013. The asset allocation, while diverse, is somewhat aggressive, in our view. As of Dec. 31, 2013, the allocation included 36.6% in equities, 29.0% in absolute return investments, 16.3% in private equity, 9.9% in real assets, and 6.6% in cash and fixed income. About a quarter of the portfolio is in level 1 investments, according to the fiscal 2013 audit. Capital calls as of Jan. 22, 2013, are about $51.9 million through 2022. The college targets two years of endowment draw in liquidity plus half of the unfunded private commitments. As of March 2014, about $103 million of investments would be available within a week, an additional $11 million with a month, and about double that within three months. The endowment draw was 5.3% and about $19.7 million in fiscal 2013.

## Reed College

| | Fiscal Year Ended | | | |
|---|---|---|---|---|
| | **2013** | **2012** | **2011** | **2010** |
| **Enrollment and demand** | | | | |
| Headcount (HC) | 1,455 | 1,474 | 1,477 | 1,481 |
| Full-time equivalent (FTE) | 1,418 | 1,441 | 1,433 | 1,437 |
| Freshman acceptance rate (%) | 35.9 | 39.8 | 42.6 | 40.5 |
| Freshman matriculation rate (%) | 28.4 | 30.7 | 28.5 | 28.7 |
| Undergraduates as a % of total enrollment | 98.4 | 98.8 | 98.0 | 98.0 |
| Freshman retention (%) | 91.7 | 92.5 | 89.9 | 89.1 |
| Graduation rates (5 years) (%) | 79.8 | 73.0 | 76.1 | 75.7 |
| **Income statement** | | | | |
| Adj. operating revenue ($000s) | 102,399 | 123,953 | 106,336 | 104,777 |
| Adj. operating expense ($000s) | 102,014 | 107,732 | 93,042 | 91,446 |
| Net operating income ($000s) | 385 | 16,221 | 13,294 | 13,331 |
| Net operating margin (%) | 0.4 | 15.1 | 14.3 | 14.6 |
| Change in unrestricted net assets ($000s) | 28,294 | 11,919 | 35,867 | 18,058 |
| Tuition discount (%) | 35.6 | 35.3 | 36.2 | 35.4 |
| Tuition dependence (%) | 58.1 | 46.9 | 52.2 | 50.8 |
| **Debt** | | | | |
| Outstanding debt ($000s) | 83,908 | 83,999 | 85,151 | 66,163 |
| Current debt service burden (%) | 3.21 | 3.00 | 3.07 | 2.04 |
| Current MADS burden (%) | 4.80 | 4.55 | 7.47 | 2.04 |
| **Financial resource ratios** | | | | |
| Endowment market value ($000s) | 480,398 | 437,081 | 406,009 | 365,594 |
| Cash and investments ($000s) | 533,448 | 492,911 | 461,100 | 407,162 |
| Unrestricted net assets ($000s) | 318,214 | 289,920 | 278,001 | 242,134 |
| Expendable resources ($000s) | 345,671 | 327,974 | 342,418 | 269,835 |
| Cash and investments to operations (%) | 522.9 | 457.5 | 495.6 | 445.2 |
| Cash and investments to debt (%) | 635.8 | 586.8 | 541.5 | 615.4 |
| Expendable resources to operations (%) | 338.8 | 304.4 | 368.0 | 295.1 |
| Expendable resources to debt (%) | 412.0 | 390.4 | 402.1 | 407.8 |
| Average age of plant (years) | 17.8 | 16.0 | 15.4 | 14.3 |

Total adj. operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adj. operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100*(net adj. operating income/adj. operating expense). Tuition dependence = 100*(gross tuition revenue/adj. operating revenue). Current debt service burden = 100*(current debt service expense/adjusted operating expenses). Current MADS burden = 100*(maximum annual debt service expense/adjusted operating expenses). Cash and investments = cash + short-term & long-term investments. Expendable resources = unrestricted net assets + temp. restricted net assets - (net PPE-outstanding debt). Average age of plant = accumulated depreciation/depreciation & amortization expense.

## Related Criteria And Research

### Related Criteria

- USPF Criteria: Higher Education, June 19, 2007
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012

| Ratings Detail (As Of April 8, 2014) | | |
|---|---|---|
| **Oregon Facs Auth, Oregon** | | |
| Reed Coll, Oregon | | |
| **Oregon Fac Auth (Reed Coll) rfdg bnds (Reed Coll) ser 2008** | | |
| *Long Term Rating* | AA-/A-1+/Stable | Affirmed |