STANDARD & POOR'S RATINGS SERVICES

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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's balanced sheet remained strong in fiscal 2012, in our opinion; the college relies heavily on the endowment for operating support. The college broke even on a budgetary basis, although results are stronger on an adjusted audited basis. We understand that the college is planning small budgetary deficits during the next two fiscal years. While applications are stable, 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 $459.8 million as of Dec. 31, 2012, and fiscal 2012 expendable resources equal to 3.1x of annual operating expenses and 3.9x of debt, which we consider good;
- Good history of fundraising, with an alumni participation rate of slightly more than 30% and a completed $200 million capital campaign; and
- Good student quality, highlighted by a median SAT score of 2076 in fiscal 2012.

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

- Strong competition, as demonstrated by only 28% of admitted students enrolling, partly mitigated by a slight, 2.4% increase in applications in fall 2012;
- The college's high reliance on investment returns for operating performance (about 25% of budget) and historically aggressive portfolio mix;
- The college's only break-even operations on a budgetary basis in fiscal 2012 (partially offset by continued positive results on an audited and adjusted operating basis), and management's expectation that operations will be slightly negative on a budgetary basis for the next two fiscal years; and
- The high maximum annual debt service (MADS) debt burden for the rating category, at 6.4%, although it has decreased from 7.5% in fiscal 2011.

Total debt as of June 30, 2012 was $84 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 2012, 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 $4.75 million and adjusted audited operating expenses in 2012, is 4.4%; when using MADS of $6.9 million (occurring in 2048), the debt burden is 6.4%, which we consider high.

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

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 2076 in fall 2011, 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 1,455 for fall 2012 (less than a 2% decline during the last four years) despite strong competition from these and other schools and declining applications

Management

The college is governed by a self-perpetuating board of trustees, which 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 plan is likely to commence by 2014. The long-serving (40 years) vice president of finance and treasurer is slated to retire within a year.

Demand

Enrollment is relatively stable at about 1,455 students in fall 2012. First-year applications improved slightly in fall 2012 after dipping for three consecutive years, which management attributes to the economic downturn and a transition in the dean of admissions position. Overall, first-year applications are down about 1% from four years ago. Reed received 3,131 applications for fall 2012, a 2.4% increase from the previous year. Overall selectivity has improved during the last four years to 35.9% in fall 2012 and remains strong relative to peer institutions' rates. 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 was 320. The matriculation rate has also remained fairly stable at 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 80% of students come from outside of Oregon. The first-second year retention rate is, in our view, very good, at roughly 91%. Tuition is $44,200 for the 2012-2013 school year. The overall tuition discount rate was 35% in fiscal 2012.

Financial Profile

Operations

With an endowment of $459.8 million as of December 2012, Reed's budget is highly reliant on endowment-generated revenue, in our view, with endowment spending accounting for 25% of fiscal 2012 revenues, or about $21 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 is aware that it may face budgetary challenges as the funding formula results in lower spendable draws due to prior weak quarters during the recession. Management has indicated that it is saving surpluses to cover possible operating shortfalls.

The college achieved modest surpluses on a budgetary basis in fiscal years 2010 and 2011 and broke even in fiscal 2012. Its audit includes unrealized/realized gains above the line ($11 million) and thus shows a $11.9 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 about $16 million in fiscal 2012 (this is somewhat overstated as net assets released from restrictions were about $15 million higher than in previous years). Further, management has budgeted for a roughly $1.8 million operating deficit for fiscal 2013 due to higher health care and retired medical costs. The college is budgeting to return to break even in fiscal 2015.

Financial resources

At June 30, 2012, Reed's financial resources ratios were down slightly from the previous year but remain good for the rating category, in our opinion, with expendable resources of $328 million equal to 3.1x of expenses and 3.9x debt. Cash and investments (which include restricted endowment) are even stronger, at $493 million, equal to 5.9x debt.

Fundraising is strong at the college, in our view: Annual fund donations totaled more than $3 million in both fiscal 2010 and fiscal 2011. The college just finished a $200 million capital campaign six months early and raised nearly all of that amount.; the majority of pledges are in hand. Reed's endowment stood at $437 million as of June 30, 2012 and $458.8 million as of Dec. 31, 2012. The asset allocation, while diverse, is somewhat aggressive, in our view. As of Dec. 31, 2012, the allocation included 32.9% in absolute return investments, 28.7% in equities, 11.5% in real assets, 16.6% in private equity, and 10.4% in cash and fixed income. About a quarter of the portfolio is in level 1 investments, according to the fiscal 2012 audit. Capital calls as of Jan. 22, 2013 are about $47.5 million through 2022. The college targets two years of endowment draw in liquidity plus half of the unfunded private commitments. The endowment draw is 5.3% and was about $21 million in fiscal 2012.

Related Criteria And Research

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

Ratings Detail (As Of February 27, 2013)		
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