MOODY'S
INVESTORS SERVICE

CREDIT OPINION
21 October 2019

Rate this Research

Contacts

Debra Roane +1.212.553.6899
VP-Sr Credit Officer
debra.roane@moodys.com

Dennis M. Gephardt +1.212.553.7209
VP-Sr Credit Officer
dennis.gephardt@moodys.com

Michael Osborn +1.212.553.7799
VP-Senior Analyst
michael.osborn@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

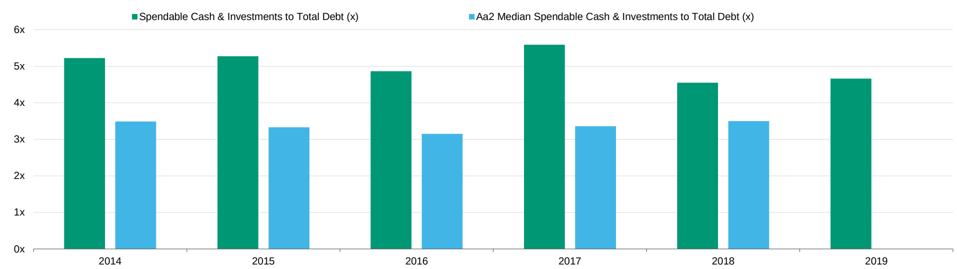
Reed College, OR

Update to credit analysis

Summary

Reed College's credit quality (Aa2 stable) reflects its steady student demand as a liberal arts college with an increasingly national brand, contributing to excellent strategic positioning. The college has generated consistently strong operating cash flow and has sizable financial reserves and robust liquidity. Offsetting considerations includes the college's relatively small scale of operations, a highly competitive environment as Reed increasingly competes against a broader pool of well resourced colleges and volatility in revenue and financial results given fluctuations in gifts for operations.

Exhibit 1
Flexible reserves provide strong buffer to debt



2019 median data is not available
Source: Moody's Investors Service

Credit strengths

» Flexible reserves support Reed's excellent strategic positioning amply cushioning operations and debt

» Very strong liquidity with over 900 monthly days cash in fiscal 2019

» Sound student market position as a nationally recognized liberal arts college accepting around 35% of applicants

» Operating performance is consistently strong, with average operating margin at 9.6% through fiscal 2019 and cash flow margin of 15.0% in fiscal 2019

Credit challenges

» Reed is increasingly competing against a broader pool of universities, some of which are better resourced

- A high cost business model and relatively small scale reduce flexibility to quickly adjust operations
- Philanthropy is low relative to peer institutions with three year average gift per student at $9,966 in fiscal 2019 compared with the Aa2 median of $19,240 (fiscal 2018)
- Potential softening in operating results with rising cost pressures and lower gifts before the initiation of a new campaign

Rating outlook

The stable outlook reflects our expectations that student demand will remain sound with consistent growth in net tuition per student in the 3-4% range, that the college will achieve higher levels of fund raising, and that there will be minimal additional borrowing.

Factors that could lead to an upgrade

- Substantial increase in cash and investments, outpacing peer growth
- Material strengthening of student demand
- Significant improvement in philanthropy

Factors that could lead to a downgrade

- Below peer growth in cash and investments over a multiyear period leading to relative credit weakening
- Inability to sustain strong operating cash flow
- Additional debt issuance

Key indicators

Exhibit 2

REED COLLEGE, OR

	2015	2016	2017	2018	2019	Median: Aa Rated Private Universities
Total FTE Enrollment	1,416	1,397	1,433	1,471	1,439	3,094
Operating Revenue ($000)	93,593	113,266	102,169	109,743	107,629	244,863
Annual Change in Operating Revenue (%)	0.6	21.0	-9.8	7.4	-1.9	3.0
Total Cash & Investments ($000)	582,522	545,945	602,435	637,396	650,352	1,426,382
Total Debt ($000)	80,644	79,165	77,790	101,995	100,530	278,625
Spendable Cash & Investments to Total Debt (x)	5.3	4.9	5.6	4.6	4.7	3.5
Spendable Cash & Investments to Operating Expenses (x)	4.8	4.1	4.7	4.8	4.7	3.0
Monthly Days Cash on Hand (x)	835	796	878	932	900	445
Operating Cash Flow Margin (%)	14.5	23.3	16.9	19.4	15.0	15.4
Total Debt to Cash Flow (x)	5.9	3.0	4.5	4.8	6.2	5.4
Annual Debt Service Coverage (x)	3.5	6.7	4.0	5.8	4.3	3.0

Source: Moody's Investors Service

Profile

Reed College, also known as The Reed Institute, is a liberal arts college enrolling approximately 1,439 students in fall 2019 and had $108 million in operating revenue in fiscal 2019. It is located in Portland, Oregon, and was founded in 1908.

Detailed credit considerations

Market profile: liberal arts college increasingly competing nationally

Reed's increasingly national brand recognition as a prestigious West Coast liberal arts college will enable the college to sustain overall steady enrollment. Continued investment in the campus and programs made possible by accumulated reserves and philanthropy support the college's excellent strategic position.

The college is meeting its target enrollment of just over 1,400 students. Strong growth in net tuition per student is an indication of clear demand and pricing power. Tuition discounting has eased gradually to 35.9% and down from 38.6% in fiscal 2016 and is projected to remain in the mid 30% range, with projected 3-4% growth in net tuition per student incorporated in the college's five year financial plan.

Reed is increasingly competing with a broader array of institutions as its geographic reach has expanded beyond the coasts and into the middle part of the country. The college has increased outreach strategies and invested in higher demand programs such as computer science, math, and environmental studies. It also invested in facilities building a new 180-bed residence and renovating other residence halls, a sports center, and science facilities to sustain its competitive position. It has restructured its financial aid packages to be more competitive, meeting full need inclusive of student loans. Nevertheless, competition and steady discount rates have contributed to declining yield on accepted students, which remained at a low 17% in fall 2019, down from 22% in fall 2015.

Operating performance: healthy operating cash flow despite volatility in gift flow, supported by strong net tuition growth

We expect operating performance to remain sound – operating cash flow margins averaged 18% from fiscal 2015 to fiscal 2019 – supported by robust growth in net tuition revenue. The college will experience some continued variability in performance based on the timing and nature of gift receipts. In fiscal 2019, revenue declined by 1.9% despite the 7% rise in net tuition, because of a sharp decline in contributions for operations. However, this trend followed a sharp rise in gifts and revenue in the prior year. Fiscal 2020 results will be softened by rising costs as capitalized interest for borrowing ends. However, the college's conservative budgeting and good control over spending should at least partially offset pressures.

Reed operates under a high cost business model based on small classes and intensive faculty interaction. A 1999 board approved resolution has a stated goal of a 10:1 faculty student ratio. This business model combined with the college's comparatively small scale -- an operating budget of $108 million -- as well strong reliance on tuition and auxiliary revenue for approximately 62% of its budget provides Reed's limited flexibility to adjust quickly to any adverse changes in its market and business conditions. The college's longer term flexibility is more substantial given its wealth levels and liquidity.

Wealth and liquidity: strong financial resources and excellent liquidity relative to commitments

The college's strong relative wealth compared to debt and operations will continue to be the primary factor supporting the Aa2 rating and underpinning its excellent strategic positioning. Spendable cash and investments cover operating expenses by 4.7x in fiscal 2019, which compares favorably with the Aa2-rated private universities median of 3.7x.

Furthering its goals on fundraising will be critical to enhancing its wealth and revenue diversity. This is a potentially longer term competitive disadvantage given its above average reliance on student charges. Reed's philanthropy is below many of its competitors with three-year average gift per student of $9,926 in fiscal 2019 compared to the $19.240 2018 median for all Aa2-rated private colleges. The college has targeted raising $50 million by fiscal 2020 as it prepares for a new comprehensive campaign. The endowment will benefit from Reed's gradual progress on reducing its endowment spending rate down to 5% by fiscal 2021 from 5.25% in fiscal 2016.

Investment returns in fiscal 2019, were a relatively weak 3.7% in fiscal 2019. In recent years, risk was lowered by slightly easing exposure to absolute return and private investments and nonmarketable alternatives to around 48% – down from 66% five years ago – and moderately increasing its exposure to fixed income and public equities.

A substantial portion of Reed's financial assets are invested with mutual funds and a comparatively large number of partnerships, 70 private equity and 15 hedge funds, adding complexity to the college's endowment management and manager oversight.

Liquidity

Liquidity will remain healthy relative to commitments, with approximately $231 million of unrestricted cash and investments that could be liquidated within a month in fiscal 2019. This provides a strong 900 days cash on hand which compares favorably to the fiscal 2018 Aa2 median of private universities of 617 days.

Unfunded commitments total $103 million in fiscal 2019, amounting to around 16% of the invested portfolio, and are a potential call on liquidity, depending on timing of calls as well as cash flow from existing investment strategies.

Leverage: moderate leverage underpins the rating

Reed's leverage profile remains moderate, although increased with the issuance of $25 million in fiscal 2018. Debt outstanding of $100 million is moderate compared to its balance sheet reserves, with spendable cash and investments coverage of debt to 4.6x compared to median of private universities rated Aa2 at 3.5x. Debt affordability is less favorable with debt at 6.2x fiscal 2019 cash flow compared with the 5.7x median.

The opening of a 180 bed residence hall including a large multipurpose classroom and common study and lounging areas in August 2019 has expanded residential capacity on campus and includes design elements and programs focussed on student support. The project is not expected to be self-supporting. A forthcoming $10 million renovation of the library will be funded through surpluses and bequests. There are no other large projects envisioned or borrowing plans.

Debt structure

Reed's healthy balance sheet and solid operations mitigate the risks from variable rate demand bonds which comprise 35% of debt. The $35 million of variable rate series 2008 A bonds are supported by a standby bond purchase agreement (SBPA) with Wells Fargo Bank N.A. that expires in 2023. The $66 million in series 2017A bonds, are fixed rate with capitalized interest until fiscal 2020 and will begin amortizing in 2027, with final maturity in 2048. There are various financial covenants associated with the bonds and SBPA, including an unrestricted liquid asset covenant under which the college has significant headroom.

Debt-related derivatives

Reed has one interest rate swap to partially hedge the interest on the series 2008 bonds with a notional value of $8.9 million and a $833 thousand swap liability in fiscal 2019.

Pensions and OPEB

Retirement benefits do not present a large credit risk for Reed. The college has a $30 million unfunded post-retirement benefit liability for a plan that was closed as of 2006 and had an annual expense of $952 thousand in fiscal 2019 or 1.0% of total expenses. The college operates a defined contribution pension plan, with an annual expense of $3.7 million as of fiscal 2019, or 3.7% of expenses, and is also manageable.

Environmental, social and governance (ESG) considerations

Like most of the higher education sector, environmental considerations are not a material credit driver for Reed College at this time.

Social risks include the impact of demographics on college enrollment. The number of Oregon high school graduates is projected to rise at less than 1% over decade through 2026 which combined with the severe competition on the Pacific North West for students can dampen student demand. However, demographic challenges are mitigated by the fact that 93% of students are drawn from other states. The college continues to actively seeking to expand recruitment efforts in new out-of-state markets to counter some of these pressures.

Governance and management are favorable with management's demonstrated ability to adjust its programs, facilities, and outreach to sustain its competitive position. Financial planning is sound, supported by five year financial modeling with realistic assumptions. In 2017, as part of an effort to refine its treasury management, the college adopted a debt policy that includes guidelines on internal debt limits based on debt to endowment and debt service to expenses metrics.

A new President joined the college in July 2019 and has significant experience at similar liberal arts colleges. The college has also adjusted its governance of investment management with an expansion of its internal staff capacity and the hiring of a CIO in August 2019 who is undertaking a full review of investments and fund managers. The rest of the senior leadership team has largely been in place since 2014 and has a good level of engagement with the Board.

Rating methodology and scorecard factors

The Higher Education Methodology includes a scorecard that summarizes the factors that are generally most important to higher education credit profiles. Because the scorecard is a summary and may not include every consideration in the credit analysis for a specific issuer, a scorecard-indicated outcome may or may not match an assigned rating. We assess strategic positioning on a qualitative basis, as described in the methodology.

Operational flexibility provided by strong cushion of reserves to both operations and debt, along with volatility in gift flow which led to a revenue decline in fiscal 2019 but is expected to rise in future years accounts for the two notch difference with the scorecard.

Exhibit 3

Reed College

Rating Factors		Value	Score
Factor 1:	**Market Profile (30%)**		
	Scope of Operations (Operating Revenue) ($000)	107,629	A2
	Reputation and Pricing Power (Annual Change in Operating Revenue) (%)	(1.9)	B1
	Strategic Positioning	Aa	Aa
Factor 2:	**Operating Performance (25%)**		
	Operating Results (Operating Cash Flow Margin) (%)	15.0	Aa3
	Revenue Diversity (Maximum Single Contribution) (%)	62.1	A2
Factor 3:	**Wealth & Liquidity (25%)**		
	Total Wealth (Total Cash & Investments) ($000)	650,352	Aa3
	Operating Reserve (Spendable Cash & Investments to Operating Expenses) (x)	4.7	Aa1
	Liquidity (Monthly Days Cash on Hand)	900	Aaa
Factor 4:	**Leverage (20%)**		
	Financial Leverage (Spendable Cash & Investments to Total Debt) (x)	4.7	Aa1
	Debt Affordability (Total Debt to Cash Flow) (x)	6.2	A1
	Scorecard-Indicated Outcome		A1
	Assigned Rating		Aa2

Data is based on most recent fiscal year available. Debt may include pro forma data for new debt issued or proposed to be issued after the close of the fiscal year.

For non-US issuers, nominal figures are in US dollars consistent with the Higher Education Methodology.

Source: Moody's Investors Service

REPORT NUMBER 1199146

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454