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INVESTORS SERVICE

Rating Update: **Moody's affirms Reed College, OR's Aa2 and Aa2/VMIG 1; outlook stable**

Global Credit Research - 16 Aug 2013

Approximately \$84 M rated debt affected

OREGON FACILITIES AUTHORITY
Private Colleges & Universities
OR

Opinion

NEW YORK, August 16, 2013 --Moody's Investors Service has affirmed Reed College's Aa2 and Aa2/VMIG 1 ratings on \$84 million of revenue bonds issued through the Oregon Facilities Authority (see RATED DEBT section). Reed's significant balance sheet strength and strong market position are key drivers of the rating and stable outlook.

SUMMARY RATING RATIONALE

The Aa2 long term rating reflects Reed College's strong student market position with growing net tuition per student, proven fund raising ability, strong financial resources, a significant portion of which are unrestricted, and consistently positive operating performance. The rating also incorporates multiple expense pressures and reliance on investment income to fund operations.

The VMIG 1 rating for the Series 2008A bonds is based on the standby bond purchase agreement (SBPA) from Wells Fargo Bank N.A. (rated Aa3 / P-1 stable) supporting the tender feature of the bonds.

STRENGTHS

*A nationally known liberal arts college, Reed has a diverse student draw which has translated into the ability to consistently grow net tuition per student.

*Philanthropic support for the college is strong, with average gifts per student of \$17,217 in Fiscal Year (FY) 2012 well in excess of the median \$10,249 average gift revenue per student for similarly rated institutions.

*Financial flexibility is enhanced due to Reed's healthy unrestricted financial resources of \$252 million, half of its total FY 2012 financial resources of \$473 million. Unrestricted resources would enable Reed to operate for nearly three full years, or to repay debt three times over.

*Reed has consistently generated positive annual operating results, with a three year average operating margin of 10.7 % (FY 2010 to 2012). Strong financial management, as evidenced by the college's conservative budgeting and demonstrated willingness to contain expenses, support this consistent performance.

CHALLENGES

*Competing with an elite group of institutions for a national student population, Reed will face continued pressure to invest in facilities and programs to remain competitive. After containing expenses in FY 2010 and FY2011, operating expenses grew by 9.3% in FY 2012 due to addition of faculty and increased healthcare costs.

*The college is moderately leveraged from an operational perspective, with debt to operating revenue of 0.97 times. Currently the college has no additional borrowing plans.

*Reed's pace of capital spending (FY 2010 to 2012 average of 1.0 time) has been lower than peers in recent years and its higher age of plant (16 years) indicate that capital needs may materialize in the medium-term.

*Reed is exposed to investment performance volatility due to its reliance on investment income to fund nearly a quarter of its operating revenues (FY 2012).

RECENT DEVELOPMENTS/RESULTS:

In July 2012 the college appointed its fifteenth president, replacing the previous president of 10 years. The long serving vice president of finance and treasurer is scheduled to retire in 2014 and a search is currently underway for a replacement. Reed is in the process of initiating a strategic plan with senior management and trustee involvement.

In January 2013 Reed concluded a seven year long Centennial Campaign raising \$203.5 million against a target of \$200 million. The bulk of the funds raised (approximately \$150 million) was added to the endowment with approximately \$13 million allocated to the construction of a new performing arts building scheduled to open in fall 2013.

MARKET POSITION: In fall 2012 Reed faced an unintended 2% decline in full time equivalent (FTE) enrollment to 1,419 FTEs from 1,441 in fall 2011. The fall 2012 entering class of 320 students was below the approximately 370 students enrolled in the prior three years with early indication of a fall 2013 class of 350 students. Demand has remained strong (36% freshman acceptance rate, 28% yield rate for fall 2012) and we view Reed as having a fundamentally sound student market position that nonetheless needs to be carefully managed due to competitive pressures. The college's FY 2012 net tuition per student of \$26,140 is indicative of Reed's continuing market strength and pricing power. Reed has consistently been able to grow net tuition per student, with a 5.9% increase in FY 2012.

OPERATING PERFORMANCE: Reed's operating margin of 8.5% in FY 2012 and cash flows of 13.7% (as calculated by Moody's assuming a 5% endowment spend rate) were strong but lower than in recent years. Reduced performance was driven by approximately \$4 million of higher expenses due to increased faculty and benefits costs as well as one-time costs related to consultants. Fiscal year 2013 operating results are expected to be in line with FY 2012.

For FY 2012 Moody's adjusted a \$7.5 million health benefit accrual to non-operating expenses, although we note that the college has exposure to health benefit cost increases through its defined benefit medical insurance plan (closed to new enrollment after 2006).

BALANCE SHEET AND CAPITAL INVESTMENT: Reed's investment portfolio at June 30, 2013 was \$482.5 million with fiscal year return of 13.2%. With almost a quarter of its income derived from investment income, Reed's credit profile is exposed to volatility in its investment portfolio. The portfolio is heavily weighted to alternative investments, including 47% exposure to hedge funds and private equity (FY 2013). As a result, assets which would be liquid within a month of \$117.2 million at FYE 2012 was lower than unrestricted financial resources, but still healthy at 515.8 days cash on hand for operations. Monthly liquidity covered demand debt over 2.6 times, mitigating the risk of this debt structure.

The Series 2008A and 2011A revenue bonds are unsecured general obligations of the college. The college is subject to certain covenants under its loan agreement and was in full compliance with covenants at FYE 2012. Approximately half of direct debt (Series 2008A) is in weekly variable rate mode with the tender feature supported a standby bond purchase agreement from Wells Fargo N.A. (Aa3 / P-1 stable) which expires in April 2015. The college is counterparty to a swap agreement with UBS AG Bank (A2 / P-1 stable) hedging a portion of the Series 2008A bonds (\$13.85 million notional amount at July 1, 2013). The college is not required to post collateral. As of July 16, 2013 the mark-to-market value of the swap was approximately \$2.1 million (liability to the college). The Series 2008A bonds amortize through 2038, whereas the Series 2011A bonds are interest only through 2025 with a final maturity in 2041.

Outlook

The stable outlook reflects expectations of continued significant balance sheet flexibility, a manageable debt profile and expectation of positive margins and favorable cash flow from operations.

WHAT COULD CHANGE THE RATING UP

The primary factor that would drive a rating upgrade is an increase in financial resources that would provide even greater financial flexibility and support of operations.

WHAT COULD CHANGE THE RATING DOWN

The rating could be downgraded if there were material decline in balance sheet strength, or if demand metrics were to decline, leading to pressure on operating performance.

KEY INDICATORS (Fiscal year ended June 30, 2012)

Operating Revenue: \$87.3 million

Full Time Equivalent (FTE) Enrollment: 1,419 students

Primary Selectivity: 35.9%

Primary Matriculation: 28.4%

Net tuition per student: \$26,140

Average Gifts per Student: \$17,217

Total Cash and Investments: \$492.9 million

Total Direct Debt: \$84.5 million

Total Comprehensive Debt*: \$84.5 million

Expendable Financial Resources to Direct Debt: 3.77 times

Expendable Financial Resources to Operations: 3.64 times

Monthly Days Cash on Hand: 515.8 days

Operating Margin: 8.5%

Operating Cash Flow Margin: 13.7%

Three-Year Average Debt Service Coverage: 4.91 times

Operating Reliance on Student Charges Revenue (% of Moody's Adjusted Operating Revenue): 58.2%

*Comprehensive Debt includes direct debt and operating leases

RATED DEBT:

Series 2008A Revenue Bonds: rated Aa2/MMIG1

Series 2011A Revenue Bonds: Aa2

PRINCIPAL METHODOLOGY USED

The principal methodology used in this rating was U.S. Not-for-Profit Private and Public Higher Education published in August 2011. An additional methodology used in the short term rating was Variable Rate Instruments Supported by Conditional Liquidity Facilities published in May 2013. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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