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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
Oregon Fac Auth (Reed Coll) rfdg bnds (Reed Coll) ser 2008		
Long Term Rating	AA-/A-1+/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA-/A-1+' and 'AA-' ratings on Oregon Facilities Authority's revenue bonds outstanding, issued for Reed College.

The 'A-1+' short-term component of the rating reflects a standby bond purchase agreement (SBPA) provided by Wells Fargo Bank N.A. The outlook on the long-term component of the ratings is stable. Reed College remains in a competitive market, as evidenced by a low 23% matriculation rate. However, applications increased in fall 2014 and fall 2015 and selectivity has increased as management targets stable enrollment levels. The college's balance sheet remained strong in fiscal 2014 (ended June 30, 2014) and operating performance improved on an audited basis and is estimated to be break even on a budgetary basis in fiscal 2015, although the college continues to rely heavily on the endowment for operating support.

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

- Growing endowment and strong balance sheet for the rating category, with fiscal 2014 expendable resources equal to 3.7x of annual operating expenses and 4.9x of debt;
- Continued positive operating results on an audited basis, despite some fluctuation, and consistent growth in net tuition revenue with expected break-even operations on a budgetary basis in fiscal 2015;
- Strong student quality, highlighted by a median SAT score of 2072 and a median 31 ACT score in fall 2014.

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

Strong competition for the college's high-quality students, as demonstrated by only 23% of admitted students enrolling in fall 2014, down from 28% two years ago; and

A rising debt service schedule and a high maximum annual debt service (MADS) debt burden for the rating category, at 6.5%, although it has decreased from 7.5% in fiscal 2011.

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 2072 in fall 2014, which we consider strong. Reed College shares student cross-applications and admissions with institutions such as Brown University, R.I.; Oberlin College, Ohio; University of Chicago, Ill.; and Pomona College, Calif.

Total debt as of June 30, 2014, was $81.8 million, slightly more than half of which was variable-rate debt (series 2008: $41.7 million). An SBPA that Wells Fargo Bank N.A. provides related to the series 2008 variable-rate demand bonds was extended in May 2015 and now expires in June 2018. Previously, the college also entered into an interest rate swap associated with former debt outstanding that had a notional amount of $16.65 million; the mark-to-market value of the swap was a negative $1.9 million as of June 25, 2015. The college's debt service structure steadily escalates to an estimated $7 million in 2041 from $4.8 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 2014, is a moderate at 4.2%, in our opinion; when using MADS of $7 million (occurring in 2041), the debt burden is 6.5%, which we consider high. We understand that the college has no plans to issue additional debt at present.

Outlook

The stable outlook reflects our expectation that, during the next two years, the college will continue to see net tuition revenue growth and post operating surpluses on an audited basis while maintaining its strong financial resources ratios.

We could take a negative rating action if enrollment declines significantly 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 a high MADS burden and a rising debt service schedule.

Enterprise Profile

Demand

The college has historically maintained relatively stable enrollment. Although headcount was down slightly in 1,394 for fall 2014 compared with 1,411 in fall 2013, management had purposely aimed for a smaller freshman class to maintain a relatively stable overall class size. Management expects to exceed its target of 380 new students in fall 2015.

Reed College continues to compete for high-quality students both nationally and regionally and has a student base that is increasingly geographically diverse, with more than 90% of its students coming from out of state. Total applications rose 37% in fall 2014 and management estimates applications are up 36% for fall 2015. Although selectivity deteriorated in fall 2013, it improved to 39% in fall 2014 from 49% in the previous year and is estimated to improve further for fall 2015. The freshman retention rate in fiscal 2015 is good at 90% and close to rating category medians, although slightly down from a high 94% in fiscal 2014. However, the matriculation rate fell to 23% in fall 2014 from 25% and 28% in the previous two years, respectively, which we consider low for the rating category and indicative of the significant regional and national competition for high quality students. Management expects the matriculation rate to remain stable at 23% in fall 2015.

Tuition is $47,500 for the 2014-2015 school year. The overall tuition discount rate was 37% in fiscal 2014, which is up slightly compared with fiscal years 2012 and 2013, although management reports it maintains a stable level of grants, on average, as it focuses more on the overall financial aid budget and how many students receive financial aid, rather than the discount rate.

Management

The college's management and board leadership has been relatively stable. The college is governed by a self-perpetuating board of trustees that consists of at least 30 members. In 2014, a new vice president and treasurer replaced the previous long-serving vice president and treasurer who retired after 40 years. The college also hired for a newly created position of vice president of admission and financial aid in 2014. Reed College is in the first phases of developing a new strategic plan that focuses on academic program investments, financial aid strategies, financial planning, and fundraising goals.

Financial Profile

Operations

Reed College's budget relies on a sizable amount of endowment-generated revenue, which somewhat diversifies the revenue base in our view -- endowment spending accounted for 22% of fiscal 2014 revenues, or about $23 million. The college reduced its annual spending rate to 5.25% from 5.30% on a rolling 13-quarter average of fair value, a rate that we still consider to be slightly above average. Although the fiscal 2015 budget originally planned for an additional 0.05% reduction to the spending rate to 5.20%, management decided to maintain the 5.25% rate for a couple years before lowering the rate to 5.20% in fiscal 2017 and 0.05% thereafter until it reaches 5.00%. Given this change as well as an additional unbudgeted $1 million in unrestricted bequests, management expects fiscal 2015 operations will end with break-even results on a budgetary basis instead of the original estimated $1.2 million operating deficit.

Net tuition revenue has grown consistently each year in the previous five years, including 2.5% in fiscal 2014. Generally, on an audited basis, we calculate operating performance by adjusting unrealized or realized gains and losses in investments. However, as Reed College accounts for a significant portion of its annual endowment spending in the gains and losses line, we historically have included a portion in the calculation of operating performance. With this adjustment, the college had a $6.6 million operating surplus of in fiscal 2014, or 6.1% of operations, which is an improvement from a small 0.4% audited operating surplus in fiscal 2013. Management is in the process of implementing a financial model, which it expects will improve long-term forecasting of major revenue and expense drivers.

Financial resources

At June 30, 2014, Reed College's financial resources ratios were improved from the previous year and remain good for the rating category, in our opinion, with expendable resources of $397 million equal to 3.7x of expenses and 4.9x debt. Cash and investments (which include restricted endowment) are even stronger, at $589 million, equal to 5.5x operations and 7.2x debt.

Reed College's endowment improved 11% to $550 million as of June 30, 2014, from $494 million at June 30, 2013. The fund's asset allocation, while diverse, is somewhat aggressive, in our view. As of May 31, 2015, of a total $553 million portfolio market value, the allocation included 35% in equities, 29% in absolute return investments, 17% in private equity, 9% in real assets, and 5% in cash and fixed income. The college's investment committee has recently reduced the targeted allocation for absolute return investments to 20% with a goal to increase private investments and more liquid traditional investments. We view audited investment classifications as a proxy for the relative liquidity of an institution's investments. About 20% the portfolio is in level 1 investments, according to the fiscal 2014 audit, and 76% of the portfolio is in level 3 investments, considered the most unobservable and least likely to be liquid. According to management's liquidity schedule, about 27% of total investments were illiquid as of June 30, 2015, 14% were available within one month, and 34% were available within three months.

In addition to a separate defined contribution pension plan and a defined contribution retiree health plan for employees hired after July 1, 2006, the college maintains a defined benefit retiree medical insurance plan for certain employees hired before July 1, 2006, with a total $25.5 million liability.

The college has a good history of fundraising and last finished a comprehensive capital campaign in 2012, raising $200 million in gifts and pledges. Management has no specific plans for a new campaign at this point although future fundraising is likely to be linked to the implementation of the new strategic plan. There are no plans to issue additional debt at this time.

Reed College, Oregon

	--Fiscal year ended June 30--					
	2015	**2014**	**2013**	**2012**	**2011**	**Median for private colleges and universities rated 'AA'**
Enrollment and demand						
Headcount	1,394	1,411	1,455	1,474	1,477	MNR
Full-time equivalent	1,360	1,378	1,418	1,441	1,433	3,749
Freshman acceptance rate (%)	38.7	48.5	35.9	39.8	42.6	26.5
Freshman matriculation rate (%)	22.7	25.4	28.4	30.7	28.5	34.3
Undergraduates as a % of total enrollment (%)	98.6	98.9	98.4	98.8	98.0	72.2
Freshman retention (%)	89.5	94.1	91.7	92.5	89.9	94.4
Graduation rates (five years) (%)	78.7	76.7	79.8	73.0	76.1	87.3
Income statement						
Adjusted operating revenue ($000s)	N.A.	114,222	102,399	123,953	106,336	MNR
Adjusted operating expense ($000s)	N.A.	107,605	102,014	107,732	93,042	MNR
Net operating income ($000s)	N.A.	6,617	385	16,221	13,294	MNR
Net operating margin (%)	N.A.	6.15	0.38	15.06	14.29	MNR
Change in unrestricted net assets ($000s)	N.A.	40,507	28,294	11,919	35,867	MNR
Tuition discount (%)	N.A.	36.7	35.6	35.3	36.2	36.4
Tuition dependence (%)	N.A.	54.4	58.1	46.9	52.2	MNR

Reed College, Oregon (cont.)						
Debt						
Outstanding debt ($000s)	N.A.	81,873	84,341	84,449	85,151	252,800
Current debt service burden (%)	N.A.	4.21	3.21	3.00	3.07	4.00
Current MADS burden (%)	N.A.	6.51	6.86	6.50	7.47	MNR
Financial resource ratios						
Endowment market value ($000s)	N.A.	550,483	494,051	437,081	406,009	1,163,613
Cash and investments ($000s)	N.A.	589,544	533,448	492,911	461,100	MNR
Unrestricted net assets ($000s)	N.A.	358,721	318,214	289,920	278,001	MNR
Expendable resources ($000s)	N.A.	397,313	346,104	328,424	342,418	MNR
Cash and investments to operations (%)	N.A.	547.9	522.9	457.5	495.6	378.4
Cash and investments to debt (%)	N.A.	720.1	632.5	583.7	541.5	463.1
Expendable resources to operations (%)	N.A.	369.2	339.3	304.9	368.0	250.4
Expendable resources to debt (%)	N.A.	485.3	410.4	388.9	402.1	323.1
Average age of plant (years)	N.A.	17.6	17.8	16.0	15.4	13.0

Total adjusted operating revenue = unrestricted revenue less realized and unrealized gains/losses and financial aid. Total adjusted operating expense = unrestricted expense plus financial aid expense. Net operating margin = 100*(net adjusted operating income/adjusted operating expense). Tuition dependence = 100*(gross tuition revenue/adjusted 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 and long-term investments. Expendable resources = unrestricted net assets + temp. restricted net assets - (net PPE - outstanding debt). Average age of plant = accumulated depreciation/depreciation and amortization expense. N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service.

Related Criteria And Research

Related Criteria

- USPF Criteria: Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015
- Criteria: Methodology Applied To Bank Branch-Supported Transactions, Oct. 14, 2013
- Criteria: Use of CreditWatch And Outlooks, Sept. 14, 2009
- USPF Criteria: Standby Bond Purchase Agreement Automatic Termination Events, April 11, 2008
- USPF Criteria: Bank Liquidity Facilities, June 22, 2007
- USPF Criteria: Higher Education, June 19, 2007