MOODY'S INVESTORS SERVICE

CREDIT OPINION
25 October 2017

New Issue

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Reed College (OR)

New Issue - Moody's assigns Aa2 to Reed College's (OR) series 2017A bonds; outlook stable

Summary Rating Rationale

Moody's Investors Service has assigned a Aa2 rating to Reed College's (OR) proposed $63 million of revenue bonds, series 2017A to be issued through the Oregon Facilities Authority with a projected July 1, 2048 maturity. Moody's maintains Aa2 and Aa2/VMIG 1 ratings on outstanding debt, with the short term rating supported by a standby bond purchase agreement with Wells Fargo Bank N.A.. The outlook is stable.

The Aa2 rating incorporates Reed's 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 sizeable financial reserves and very good liquidity. Offsetting considerations include a growing leverage and an ever more competitive environment as Reed increasingly competes against a broader pool of well-resourced colleges.

Credit Strengths

» Total cash and investments in excess of $600 million support Reed's excellent strategic positioning

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

» Operating performance is consistently strong, albeit somewhat variable due to gift flow

» Very strong liquidity with over 880 monthly days cash

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 provide little flexibility to quickly adjust operations if necessary

» Philanthropy is low relative to peer institutions

» Increasing leverage leaves limited room for additional borrowing at this rating category

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 move closer to its goal of announcing its prospective fundraising campaign, and that there will be minimal additional borrowing following the forthcoming debt issuance.

Factors that Could Lead to an Upgrade

» Substantial increase in cash and investments, outpacing peer growth

» Material strengthening of student demand and philanthropy

Factors that Could Lead to a Downgrade

» Below peer growth in cash and investments over a multi-year period leading to relative credit weakening

» Inability to sustain strong operating cash flows

» Additional debt issuance

Key Indicators

Exhibit 1
REED COLLEGE, OR

	2013	2014	2015	2016	2017	2017 Sensitivity Series2017A	Median: Aa Rated Private Universities
Total FTE Enrollment	1,378	1,359	1,416	1,397	1,433	1,433	2,946
Operating Revenue ($000)	83,698	93,040	93,593	113,266	102,169	102,169	229,019
Annual Change in Operating Revenue (%)	-4.0	11.2	0.6	21.0	-9.8	-9.8	4.5
Total Cash & Investments ($000)	533,448	583,370	582,522	545,945	602,435	602,435	1,088,617
Total Debt ($000)	84,397	81,873	80,644	79,165	77,790	103,735	246,839
Spendable Cash & Investments to Total Debt (x)	4.5	5.2	5.3	4.9	5.6	4.2	3.0
Spendable Cash & Investments to Operating Expenses (x)	4.7	5.0	4.9	4.1	4.7	4.7	2.9
Monthly Days Cash on Hand (x)	867	946	840	800	884	884	449
Operating Cash Flow Margin (%)	10.9	16.0	14.5	23.3	16.9	16.9	14.6
Total Debt to Cash Flow (x)	9.2	5.5	5.9	3.0	4.5	6.0	5.3
Annual Debt Service Coverage (x)	3.9	3.3	4.0	7.6	4.7	4.7	3.1

Source: Moody's Investors Service

Detailed Rating Considerations

Market Profile: Wealthy 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 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 approximately 1,400 students. 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. This is reflected in a declining yield rate on accepted students, which remained at a low 20% in fall 2017, after declining in fiscal 2016, with some moderate year to year volatility in the entering class.

The college has increased outreach strategies, invested in higher demand programs such as computer science, math, and environmental studies, and made renovations to its residence halls, sports center, and science facilities to sustain its competitive position. It has also restructured its financial aid packages to be more competitive, meeting full need inclusive of student loans. Tuition discounting is reasonably forecast to stabilize 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's philanthropy, while very good within the broader context of the higher education landscape, is below many of its competitors. Three-year average gift revenue of around $17 million compares to a median of just over $40 million for all Aa2-rated private colleges. This is a potentially longer term competitive disadvantage. Favorably, the college is in the early planning stages for a new campaign, with goals yet to be determined, that provides prospects for improved levels of gift giving.

Operating Performance: Consistently healthy operating cash flow with moderate prospects for revenue growth

With reasonable expectations for tuition revenue growth and gift flow as the college begins planning for a campaign, we expect operating performance to remain sound. The college relies on tuition and auxiliary revenue for approximately 55% of its budget, income from investments for 28%, and gifts and other sources for the remainder. Reed's steady state operating cash flow margin has been in the 15% range in recent years, and was 17% in fiscal 2017, and down from over 25% in fiscal 2016, following a year with unusually strong gift flow. We expect some continued variability in performance based on the timing and nature of gift receipts.

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 just over $100 million -- provides Reed 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.

Over the medium term, limited growth in investment income to support operations will be a budget pressure. Positively, Reed continues to make gradual progress on reducing its own budgeted endowment spending rate down to 5.2% in fiscal 2017, from 5.25% in fiscal 2016, ultimately to reach 5% by fiscal 2021. Improved investment returns in fiscal 2017, which rose 12.4% following a decline of 5.4% in fiscal 2016, will support higher endowment spending in the future.

Wealth and Liquidity: Strong financial resources and excellent liquidity relative to commitments

The college's strong relative wealth remains the primary factor supporting the Aa2 rating. Total cash and investments are in excess of $600 million, with a substantial 70% spendable over a medium term time frame. Spendable cash and investments cover operating expenses by 4.7x in fiscal 2017, which compares favorably with the Aa2-rated private universities median of 3.4x.

The potential for a relative weakening of its credit profile compared to Aa2-rated peers due to weaker investment performance and lower gift revenue is a longer term credit risk. In addition to lowering its spending rate and beginning to plan for its next campaign, the college has made adjustments to its investment management including easing exposure to absolute return and private investments and illiquids and moderately increasing its exposure to fixed income. As of year-end fiscal 2017, Reed had a 23% allocation to absolute return and 29% to private investments and illiquids for a combined exposure to these investments of 53%, which was down from 66% five years ago.

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. Endowment management is provided by investment committee, an external consultant, and a senior investment officer reporting to the Vice President and Treasurer of the College.

In fiscal 2017, the college changed its accounting policy with regard to how it applied realized gains to its unrestricted and temporarily restricted net assets. As a result, there has been an increase in temporarily restricted net assets and an offsetting decrease in unrestricted net assets, but no impact to total assets and therefore no credit impact.

LIQUIDITY

Liquidity remains healthy relative to commitments, with approximately $211 million of unrestricted cash and investments that could be liquidated within a month in fiscal 2017. This provides a strong 884 days cash on hand. The college has revised its reporting of investment categories which in the past years had resulted in an underreporting of amounts that would be available to the college within a 30 day period. The amount of monthly liquidity as reported for fiscal 2016 as a percent of total cash and investment was revised to 36% from 17% as reported earlier, and was 35% in fiscal 2017, which is above the median of 27% for Aa-rated private universities.

The college's investment strategies, rather than externally imposed use restrictions, are the key limiting factor to liquidity. Unfunded commitments total nearly $100 million and are a potential call on liquidity, depending on timing of calls as well as cash flow from existing investment strategies.

Leverage: Growing leverage leaves little debt capacity at current rating

Reed's historic low leverage position is shifting with the series 2017A bond issuance. Debt outstanding of $78 million is modest compared to its balance sheet reserves, but the debt burden will rise with the issuance of $25 million in new money. Following this issuance, spendable cash and investments coverage of pro forma debt will decrease to 4.2x from 5.6x, and debt to operations will rise to 1.0x from 0.8x, leaving the college with limited debt capacity at this rating absent growth of reserves.

The new issuance will be partially used to build a new 180 bed residence hall, large multipurpose classroom and common study and lounging areas to open in winter 2018. This will expand residential capacity on campus and include a focus on pastoral care for students. The project is not expected to be self supporting.

DEBT STRUCTURE

Reed's healthy balance sheet and solid operations mitigate any risk from variable rate demand bonds, and provide for strong coverage of covenants. The series 2017A bonds will be fixed rate and amortizing. Reed has two other series of bonds outstanding: $40 million of fixed rate series 2011 bonds and $39 million of variable rate series 2008 bonds supported by a stand-by bond purchase agreement (SBPA) with Wells Fargo Bank N.A. Debt is amortizing through 2041, and modestly escalating, with principal payments on the series 2011 bonds commencing in 2026. There are various financial covenants associated with the bonds and SBPA, including an unrestricted liquid asset covenant under which the college has significant headroom.

Amortization on the forthcoming series 2017A bonds will begin in 2027, with final maturity in 2048.

DEBT-RELATED DERIVATIVES

Reed has one $16.6 million interest rate swap to partially hedge the interest on the series 2008 bonds. As of fiscal year end 2017, the college recorded a $1.3 million swap liability.

PENSIONS AND OPEB

Retirement benefits do not present a large credit risk for Reed. The college has a $27 million unfunded postretirement benefit liability for a plan that was closed as of 2006 and had an annual expense of $2.2 million in fiscal 2017. This liability is manageable in the broader context of Reed's credit profile amounting to 2.4% of total expenses. The college operates a defined contribution pension plan, with an annual expense of $3.5 million as of FY 2017, or 3.8% of expenses, and is also manageable relative to cash flow.

Governance and Management: Excellent strategic position benefits from good planning and investments

Management has demonstrated an 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.

The senior leadership team has largely been in place since 2014 and the President has just completed five years at the college.

Legal Security

Loan repayments from Reed College to the Oregon Facilities Authority are unsecured general obligations of the college.

Use of Proceeds

The $63 million in proceeds of the series 2017A revenue bonds will be used to advance refund the outstanding principal of series 2011A bonds, finance a new residence hall, and pay issuance costs.

Obligor Profile

Reed College, also known as The Reed Institute, is a liberal arts college enrolling approximately 1,400 students. It is located in Portland, Oregon, and was founded in 1908.

Methodology

The principal methodology used in this rating was Global Higher Education published in November 2015. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Ratings

Exhibit 2

Reed College, OR

Issue	Rating
Revenue Bonds Series 2017A	Aa2
Rating Type	Underlying LT
Sale Amount	$63,385,000
Expected Sale Date	11/07/2017
Rating Description	Revenue: 501c3 Unsecured General Obligation

Source: Moody's Investors Service

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