MOODY'S
INVESTORS SERVICE

CREDIT OPINION
9 February 2022

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

Patrick McCabe +1.212.553.4506
Assistant Vice President - Analyst
patrick.mccabe@moodys.com

CLIENT SERVICES

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

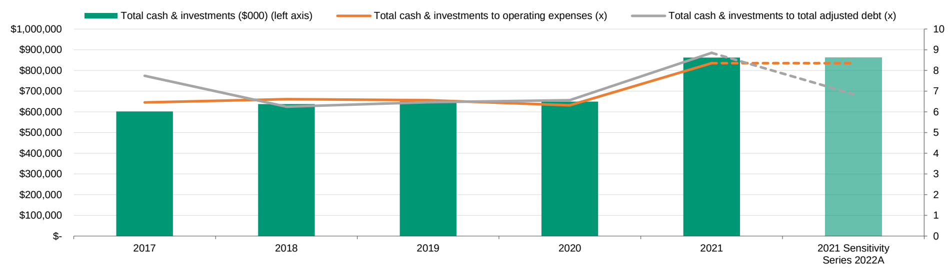
Reed College, OR

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 its excellent brand and strategic positioning. The college has sizable financial reserves and robust liquidity that provide a strong cushion to operations and debt. Offsetting considerations includes the college's relatively small scale of operations and a highly competitive environment as Reed increasingly competes against a broader pool of well-resourced colleges. EBIDA margins while sound are somewhat narrower than peers. A planned refinancing will move all bonded debt to a 30 year bullet maturity, encumbering future debt flexibility as compared to amortizing debt.

Exhibit 1
Rising cash and investments helps offset increased leverage



Source: Moody's Investors Service

Credit strengths

» Total cash and investments of $862 million provide ample cushion to operations and pro forma total debt of 8.4x and 6.9x respectively

» Very strong liquidity with over 1,000 monthly days cash in fiscal 2021

» Sound student market position as a nationally recognized liberal arts college accepting around 44% of applicants

» Generally strong growth in net tuition help support sound operating performance despite volatility in some years

Credit challenges

» Reed is increasingly competing against a broader pool of universities, some of which are better resourced, reflected in a fairly low yield of accepted students

» 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 $10,981 in fiscal 2021 compared with the Aa2 median of $24,099

» Pro forma debt structure with bullet maturity requires consistent treasury management to maintain credit quality

Rating outlook

The stable outlook reflects our expectations that EBIDA margins will strengthen in fiscal 2022 and over the next several years to closer to the 18% to 20% range registered in earlier years, and that the college will achieve higher levels of donor support, maintaining growth in cash and investments. Expectations of minimal additional borrowing also supports the stable outlook.

Factors that could lead to an upgrade

» Substantial increase in cash and investments, outpacing peer growth

» Significant improvement in philanthropy to bring in line with peers

» Material strengthening of student demand

Factors that could lead to a downgrade

» Below peer growth in cash and investments leading to relative weakening

» Inability to consistently generate strong EBIDA margins and debt service coverage

» Additional debt issuance

Key indicators

Exhibit 3
Reed College, OR

	2017	2018	2019	2020	2021	proforma	Median: Aa Rated Private Universities
Total FTE Enrollment	1,433	1,471	1,439	1,355	1,532	1,532	2,996
Operating Revenue ($Million)	102.2	109.7	107.6	114.7	111.1	111.1	264.1
Annual Change in Operating Revenue (%)	-9.8	7.4	-1.9	6.6	-3.2	-3.2	1.3
Total Cash & Investments ($Million)	602.4	637.4	650.4	649.6	862.1	862.1	1,515.4
Total Debt ($Million)	77.8	102.0	100.5	99.0	97.4	125.0	313.8
Total Cash & Investments to Total Adjusted Debt (x)	7.7	6.2	6.5	6.6	8.9	6.9	4.5
Total Cash & Investments to Operating Expenses (x)	6.5	6.6	6.6	6.3	8.4	8.4	4.9
Monthly Days Cash on Hand (x)	878	932	900	819	1,059	1,059	435
EBIDA Margin (%)	16.9	19.4	15.0	18.8	15.5	15.5	15.6
Total Debt to EBIDA (x)	4.5	4.8	6.2	4.6	5.7	7.3	6.3
Annual Debt Service Coverage (x)	4.0	5.8	4.3	4.4	3.8	3.8	3.5

Proforma debt included $15.5 million of new money borrowing and amounts for escrow deposit.
Source: Moody's Investors Service

Profile

Reed College, also known as The Reed Institute, is a liberal arts college enrolling approximately 1,532 students in fall 2021 and had $111 million in operating revenue in fiscal 2021. It is located five miles southeast of downtown Portland 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 brand and strategic positioning. Strong recovery from pandemic declines with 13.0% rise in enrollment in fall 2021 following 5.8% decline in fall 2020 indicates favorable demand as does the record increase in the starting class of 38% to 502.

Strong growth in net tuition per student is an indication of clear demand and pricing power. Tuition discounting, at 37.4% in fiscal 2021, was down from 38.6% in fiscal 2016 and is projected to remain fairly stable.

Reed increasingly competes with a broader array of institutions as its geographic reach has expanded. 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 hall and renovating other residence halls and science facilities, along with plans to rebuild its sports 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 are a low 16% in fall 2021, down from 20% in fall 2016.

Operating performance: healthy operating cash flow supported by strong net tuition growth although generally thinner than peers

We expect Reed's operating performance to strengthen in fiscal 2022 as net tuition increases by over 6% and auxiliary revenue recovers to pre-Covid trends. This follows a thinning of EBIDA margins in fiscal 2021 – to a still good 15.5% – but down from an average of 19% over the prior five years. The thinning reflected covid-related revenue losses, in particular low occupancy of student residences, and elevated costs for safety protocols. The college can experience some variability in performance given its smaller size and volatility in operating gifts, however, the college's conservative budgeting and good control over spending offset these challenges.

Reed operates under a high cost business model based on small classes – student/teacher ratio of 9.4x – and intensive faculty interaction. This business model combined with the college's comparatively small scale, with an operating budget of $111 million, as well as strong reliance on tuition and auxiliary revenue that accounts for approximately 54% of its budget, limits Reed's 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 operations will continue to be the primary factor supporting credit quality. Total cash and investments of $862 million cover operating expenses by 8.4x in fiscal 2021, which is in line with its Aa2-rated private university peers. Over the past five years through fiscal 2021, the college's wealth rose 43% which is slightly ahead of its peers. The spending power of the endowment will benefit from Reed's progress on reducing its endowment spending rate down to 5.0% in fiscal 2021 from 5.25% in fiscal 2016.

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 has been below many of its competitors with three-year average gift per student of $10,981 in fiscal 2021 compared to the $24,099 median for all Aa2-rated private colleges. The college exceeded its $50 million short term fund raising goal and is preparing for a new, much larger, comprehensive campaign.

Investment returns in fiscal 2021, were a very strong 39.5%. There is a risk given exposure to absolute return and private investments and nonmarketable alternatives which comprise around 56% of investments, but unfunded commitments remain manageable.

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

Liquidity

Liquidity will remain healthy relative to commitments, with approximately $281 million of unrestricted cash and investments that could be liquidated within a month in fiscal 2021. This provides a strong 1,059 days cash on hand which compares favorably to the median of Aa2-rated private universities of 741 days.

Unfunded commitments total $118 million in fiscal 2021, amounting to around 14% of the invested portfolio, remain manageable but are a potential call on liquidity, depending on timing of calls as well as cash flow from existing investment strategies.

Leverage: moderately high leverage with bullet maturity that limits flexibility

Reed's leverage profile will rise with planned new money borrowing of $15.5 million and amounts deposited in an escrow account as part of an advanced refunding. While proforma debt of around $125 million is moderate compared to its financial resources, with total cash and investments 6.9x total adjusted pro forma debt, it is still a bit weaker than the 7.7x. median of private universities rated Aa2. Debt affordability is less favorable with pro forma total debt at 7.3x fiscal 2021 EBIDA compared with the 5.0x median. While there are no further borrowing plans, the absence of amortization limits future flexibility.

The new money borrowing will fund the construction of two gymnasiums and related capital projects following damage due to a storm last year. A forthcoming $12.6 million renovation of the library was delayed and will be funded through surpluses and gifts. In August 2019 a 180 bed residence hall including a large multipurpose classroom and common study and lounging areas was completed. There are no other large capital projects or near term borrowing plans.

Legal security

Reed College's bonds are unsecured general obligations of the college.

Debt structure

Reed's debt structure will substantially change with a planned refinancing of all outstanding and amortizing debt to a 30 year bullet structure. Refunded debt includes variable rate bonds that comprise around one third of debt, which will remove interest rate risk and covenants included in a related standby bond purchase agreement (SBPA). It will also provide budgetary relief by reducing debt service, however, the absence of debt amortization with the bullet maturity reduces future borrowing flexibility. Favorably, plans to internally set aside amounts equal to current debt service will be invested with the intention retiring the debt in 2052. This arrangement will require consistent treasury management over a long period to maintain credit quality.

The $32 million of variable rate series 2008A bonds are supported by a SBPA with Wells Fargo Bank N.A. that expires in 2023 and is subject to the refinancing. The $66 million in series 2017A bonds, also subject to refinancing 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 2008A bonds with a notional value of $6.6 million and a $605 thousand swap liability in fiscal 2021, estimated as of February 2022 to be $325 thousand. The college plans to eliminate the swap as part of the current plan to refinance variable rate debt to fixed debt.

Pensions and OPEB

Retirement benefits do not present a large credit risk for Reed. The college operates a defined contribution pension plan, with an annual expense of $3.9 million as of fiscal 2021, or a manageable 3.8% of expenses,

The college also has a $31 million unfunded post-retirement benefit liability for a plan that was closed as of 2006 and a defined contribution health plan that together had an annual expense of $1.0 million in fiscal 2021 or 1.1% of total expenses.

ESG considerations

Environmental

Like most of the higher education sector, environmental considerations are not a material credit driver for Reed College at this time. Moody's ESG Solutions reports that Portland, Oregon where Reed is located has a high exposure to wildfires.

Social

Social risks include the impact of demographics on college enrollment and changing consumer preference. Heightened competition in the Pacific Northwest for students can dampen student demand and pricing power. However, demographic challenges are mitigated by the fact that 90% of students are drawn from other states. The college continues to actively seek to expand recruitment efforts in new out-of-state markets to counter some of these pressures.

Governance

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.

Some changes to the leadership team since a new President joined the college in July 2019 (with significant experience at similar liberal arts colleges) incudes a new Vice President and Treasurer in July 2021, and Vice President of Student Life in August 2020.

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 undertook 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 principal methodology used in this rating was Higher Education Methodology published in August 2021. 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 brand and strategic positioning, financial policy and strategy, and operating environment on a qualitative basis.

Exhibit 4

Reed College

Scorecard Factors and Sub-factors		Value	Score
Factor 1:	**Scale (15%)**		
	Adjusted Operating Revenue (USD Million)	111	A
Factor 2:	**Market Profile (20%)**		
	Brand and Strategic Positioning	Aa	Aa
	Operating Environment	A	A
Factor 3:	**Operating Performance (10%)**		
	EBIDA Margin	16%	A
Factor 4:	**Financial Resources and Liquidity (25%)**		
	Total Cash and Investments (USD Million)	862	Aa
	Total Cash and Investments to Operating Expenses	8.4	Aaa
Factor 5:	**Leverage and coverage (20%)**		
	Total Cash and Investment to Total Adjusted Debt	6.9	Aa
	Annual Debt Service Coverage	3.8	A
Factor 6:	**Financial Policy and Strategy (10%)**		
	Financial Policy and Strategy	Aa	Aa
	Scorecard-Indicated Outcome		Aa3
	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.

Values are pro forma including 2022 plan of finance
Source: Moody's Investors Service

REPORT NUMBER 1318627

CLIENT SERVICES

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

MOODY'S
INVESTORS SERVICE