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Oregon Facilities Authority Reed College; Private Coll/Univ - General Obligation

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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

Rationale

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

We assessed Reed's enterprise profile as very strong, characterized by good selectivity, above-average student quality, and sound management team. We assessed Reed's financial profile as very strong, with solid operating performance, sound expendable resources, moderate dependence on student and endowment revenues, and average maximum annual debt service (MADS) burden. Combined, we believe these credit factors lead to an indicative standalone credit profile of 'aa-' and a final rating of 'AA-'.

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.

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

- Improving student quality and increased selectivity, highlighted by a median ACT score of 31 in fall 2016;
- Consistently positive operating margins, with fiscal 2016 producing a strong, 14% margin; and
- Robust balance sheet for the rating category, with fiscal 2016 expendable resources equal to 2.93x of annual operating expenses and 4.45x of debt.

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

- Increased competition for the college's high-quality students, as demonstrated by only 20% of admitted students enrolling in fall 2016, down from about 22% in each of the two previous fiscal years, and
- Weak market returns, with fiscal 2016 experiencing a negative 5.36% return to Reed's endowment, which is of particular concern given Reed's moderate reliance on endowment for operating support.

Founded in 1908, Reed College is a liberal-arts institution that attracts high-quality undergraduate students from across the U.S. The median freshman ACT score was 31 in fall 2016, which is significantly above average. Reed College shares student cross-applications and admissions with institutions such as Brown University, R.I.; University of California Berkeley, Calif.; University of Chicago, Ill.; and Pomona College, Calif.

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Outlook

The stable outlook reflects our expectation that, during the next two years, the college will maintain operating performance, its student enrollment and demand, and its already robust financial resources. Although the college is considering possible additional debt related to residence halls in 2018, the timing, amount, and approval of such plans are uncertain and, as such, are not incorporated into this analysis.

Downside scenario

We could take a negative rating action if enrollment or matriculation declines significantly, available resources decrease significantly, or the college reports persistent operating deficits.

Upside scenario

Although not expected during the outlook period, we could consider a higher rating with significant and consistent improvement to operating performance and matriculation rates, as well as the successful initiation of a new capital campaign.

Enterprise Profile

Industry risk

Industry risk addresses the higher education sector's overall cyclicality and competitive risk and growth by applying various stress scenarios and evaluating barriers to entry, levels and trends of profitability, substitution risk, and growth trends observed in the industry. We believe the higher education sector represents a low credit risk when compared with other industries and sectors.

Economic fundamentals

In our view, the college has exceptional geographic diversity, with only 7% of fall 2016 students coming from Oregon. As such, our assessment of Reed's economic fundamentals is anchored by the U.S. GDP per capita.

Market position and demand

The college has historically maintained relatively stable enrollment. Although full-time enrollment (FTE) was down slightly in fall 2016 at 1,397 students compared with 1,416 students in fall 2015, the broad five-year trend indicates that enrollment has historically fluctuated around the 1,400 student level, with a low of 1,360 FTE in fall 2014 and a high of 1,418 in fall 2012. Management has stated that, going forward, it would like to maintain a student-faculty ratio of 10 to 1, and anticipates that FTE will hover around the 1,400 mark for the foreseeable future.

Reed College continues to compete for high-quality students both nationally and regionally, and its student base is increasingly geographically diverse, with 93% of its students coming from out of state. Total applications rose 5% in fall 2016 after a significant jump in applications of 36% in both fall 2015 and fall 2014. Management attributes this increase in applications to increased outreach efforts in recent years.

The college has become increasingly selective over the past several years; the acceptance rate improved significantly to 31.3% as of fall 2016 from 48.5% in fall 2013. The freshman retention rate fall 2016 is good at 87% and close to rating category medians, although slightly down from a high 94% in fall 2013. The matriculation rate at Reed College has declined consistently for the past five fiscal years, to a low of 20% in fall 2016 from a high of 31% in fall 2011. Management attributes this decreasing matriculation rate to a shift in the quality of students it attracts and the competing institutions to which they apply. We expect Reed's matriculation rates to improve, as management stated one of their goals was to make Reed's facilities and offerings more attractive to students. Reed has recently added a Computer Science major and is undertaking facilities upgrades to ensure a better student experience and to improve its matriculation rate.

Tuition is $51,850 for the 2016-2017 school year, and has increased by an average of 4% per year over the past five fiscal years. The overall tuition discount rate was 38.6% in fall 2016, which is a slight increase from 37.9% in the previous school year. However, management reports it maintains a stable level of grants, on average, and focuses on the overall financial aid budget, how many students receive financial aid, and net tuition revenues.

Management and governance

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. Reed College has had relatively few management changes; in October 2016, Reed's current controller retired. A new associate treasurer and controller started in August 2016, which provided for a transition period. In 2014, the college hired a new vice president of admission and financial aid, who has done tremendous work increasing applications to an average of 5,000 from a previous average of 3,000 prior to fall 2014. Reed's management team has continuity and experience.

Reed incorporates identified strategic priorities into annual departmental plans, budget models, and fundraising initiatives. Management stated that, as of October 2016, it seeks to increase matriculation through expanding academic program offerings, boost fundraising through a prospective new capital campaign, and build new residence halls to increase available student housing immediately around the college. In our view, the college has good management practices.

Financial Profile

Financial management policies

Reed College has formal policies for endowment, investments, and debt. Reed also has a formal endowment liquidity policy and meets standard annual disclosure requirements. The financial policies assessment reflects our opinion that, while there may be some areas of risk, the organization's overall financial policies are not likely to negatively affect its future ability to pay debt service. Our analysis of financial policies includes a review of the organization's financial reporting and disclosure, investment allocation and liquidity, debt profile, contingent liabilities, and legal structure and a comparison of these policies to those of comparable providers.

Financial performance

Reed College has decreased its reliance on endowment spending in recent years in an effort to preserve its endowment, accounting for 21% of fiscal 2016 revenues, or about $26.0 million, which is consistent with prior years. As of fiscal 2015, 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.

Net tuition revenue has been fairly stable year to year, most recently growing by 7.8% to $41.7 million in fiscal 2016. 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 surplus of $16.8 million, or 14% of operations, in fiscal 2016, which would be a significant improvement from fiscal 2015, when Reed produced a smaller surplus of $4 million, or a 3.6% operating margin. Reed has produced variable, though positive, margins over the past five years driven by fluctuations in gift and pledge revenue. According to management's five-year financial model, Reed is targeting for positive operations on a budgetary basis with a $1 million surplus that will help to support a new residence hall.

Available resources

At June 30, 2016, Reed College's available resources (as measured by expendable resources) decreased the past three years on a nominal basis. However, fiscal 2016 expendable resources equaled a still good 4.6x operating expenses and impressive 6.97x debt. In our opinion, Reed College's available resource measures continue to be robust for the rating, though these ratios could become pressured over time if expendable resources continue to decline or if Reed decides to issue additional debt.

Reed College's endowment decreased to $504 million as of June 30, 2016, from $551 million at June 30, 2015. As of Aug. 31, 2016, of a total $509 million total portfolio market value, the allocation included 31% in equities, 25% in absolute return investments, 18% in private equity, 12% in real assets, and 11% in cash and fixed income. According to management's liquidity schedule, about 34% of total investments were illiquid as of Sept. 20, 2016; 19% were available within one month; and 35% 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 $26.5 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. The college is in the early planning phase of a new capital campaign. In 2016, fundraising generated over $25 million in revenue.

Debt and contingent liabilities

Total debt as of June 30, 2016, was $79.2 million, roughly less than half of which was variable-rate debt (series 2008: $36.1 million). Wells Fargo Bank N.A. provides an SBPA for the series 2008 variable-rate demand bonds expiring June 2018. The college has one interest rate swap with a notional amount of $16.65 million; the mark-to-market value of the swap was a negative $2.0 million as of June 30, 2016. The college's debt service structure steadily escalates to an estimated $7.0 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 when using MADS of $7 million (occurring in 2041), the debt burden is 5.8%, which we consider moderate. We understand that the college is planning to issue approximately $20 million-$25 million in new debt, with presentation to the board in spring 2017, which could weaken the MADS burden.

Reed College, Oregon

	Fiscal year ended June 30,					Medians
	2017	2016	2015	2014	2013	Private Colleges & Universities 'AA' 2015
Enrollment and demand						
Headcount	1,427	1,453	1,394	1,411	1,455	MNR
Full-time equivalent	1,397	1,416	1,360	1,378	1,418	3,761
Freshman acceptance rate (%)	31.3	35.0	38.7	48.5	35.9	27.4
Freshman matriculation rate (%)	19.9	22.3	22.7	25.4	28.4	MNR
Undergraduates as a % of total enrollment (%)	98.8	98.4	98.6	98.9	98.4	73.9
Freshman retention (%)	86.9	87.9	89.5	94.1	91.7	95.0
Income statement						
Adjusted operating revenue ($000s)	N.A.	137,251	114,899	114,222	102,399	MNR
Adjusted operating expense ($000s)	N.A.	120,368	110,862	107,605	102,014	MNR
Net operating income ($000s)	N.A.	16,883	4,037	6,617	385	MNR
Net operating margin (%)	N.A.	14.03	3.64	6.15	0.38	1.15
Change in unrestricted net assets ($000s)	N.A.	(8,033)	14,439	40,507	28,294	MNR
Tuition discount (%)	N.A.	38.6	37.9	36.7	35.6	36.9
Tuition dependence (%)	N.A.	49.5	54.2	54.4	58.1	MNR
Student dependence (%)	N.A.	60.0	66.0	66.0	70.7	62.5
Research dependence (%)	N.A.	1.7	1.7	1.1	1.2	MNR
Debt						
Outstanding debt ($000s)	N.A.	79,240	80,644	81,873	84,341	250,895
Current debt service burden (%)	N.A.	2.83	3.03	4.21	3.21	MNR
Current MADS burden (%)	N.A.	5.82	6.32	6.51	6.86	5.24
Financial resource ratios						
Endowment market value ($000s)	N.A.	503,675	550,982	550,483	494,051	1,166,109
Cash and investments ($000s)	N.A.	552,557	588,695	589,544	533,448	MNR
Unrestricted net assets ($000s)	N.A.	365,127	373,160	358,721	318,214	MNR
Expendable resources ($000s)	N.A.	352,619	396,422	397,313	346,104	MNR
Cash and investments to operations (%)	N.A.	459.1	531.0	547.9	522.9	368.0
Cash and investments to debt (%)	N.A.	697.3	730.0	720.1	632.5	462.6
Expendable resources to operations (%)	N.A.	293.0	357.6	369.2	339.3	240.5
Expendable resources to debt (%)	N.A.	445.0	491.6	485.3	410.4	318.7
Average age of plant (years)	N.A.	16.9	15.8	17.6	17.8	13.4

N.A.--Not available. MNR--Median not reported. MADS--Maximum annual debt service. 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). Student dependence = 100*(gross tuition revenue + auxiliary 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 & long-term investments. Expendable resources = unrestricted net assets + temp. restricted net assets - (net PPE- outstanding debt). Average age of plant = accumulated depreciation/depreciation & amortization expense.

Ratings Detail (As Of November 16, 2016)		
Oregon Facs Auth, Oregon		
Reed Coll, Oregon		
Oregon Fac Auth (Reed Coll) rfdg bnds (Reed Coll) ser 2008		
Long Term Rating	AA-/A-1+/Stable	Affirmed