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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

Current

Rationale

S&P Global Ratings' long-term rating on the Oregon Facilities Authority's series 2017A revenue bonds, issued for Reed College, is 'AA-', and the outlook is stable. The long-term component of the ratings on the series 2008 bonds is 'AA-', and the outlook on the long-term component of the ratings is stable. The short-term component of the rating is 'A-1', and it reflects a standby bond purchase agreement (SBPA) provided by Wells Fargo Bank N.A.

We assessed Reed's enterprise profile as very strong, characterized by still good selectivity for the rating, stable retention, above-average student quality, and a sound management team, offset by the relatively weak and still deteriorating matriculation rate. We assessed Reed's financial profile as very strong, with consistently positive operating performance, robust expendable resource ratios for the rating, moderate dependence on student and endowment revenues, and an above-average maximum annual debt service (MADS) burden. Combined, we believe these credit factors lead to an indicative stand-alone credit profile of 'aa-' and a final rating of 'AA-'.

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

- Consistently positive operating margins, with fiscal 2018 producing a solid, 10.1% operating margin;
- Robust balance sheet for the rating category, with fiscal 2018 expendable resources equal to 3.6x of annual operating expenses and 4.3x of debt; and
- Experienced management team that has improved Reed's standing among liberal arts colleges through the recruitment and retention of quality students.

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

- Increased competition among other top liberal arts colleges for the college's high-quality students, as demonstrated by a slightly decreasing matriculation rate over the past few fiscal years;
- Above-average MADS burden of 6.5%; and
- Average endowment draw of 5.15% in fiscal 2018, though we note that the college has decreased the draw from 5.3% in fiscal 2014, with an eventual goal to decrease the draw to 5.0% by fiscal 2021.

All outstanding debt is a general obligation of the college.

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 2018, 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; University of Chicago; and Pomona College, Calif.

Outlook

The stable outlook reflects our expectation that, during the next two years, the college will continue to compete with other top liberal arts colleges for students and will continue to maintain positive operating performance, student enrollment and demand, and already robust available resources. We understand Reed is currently conducting a search for its new president, and we expect the transition to be completed in a timely manner and smoothly this year.

Downside scenario

We could take a negative rating action if enrollment or matriculation declines significantly, if the college issues significant debt such that it begins to pressure the MADS burden or available resource ratios, or if the college reports materially and consistently weaker operating performance.

Upside scenario

Although not expected during the outlook period, we could consider a higher rating with significant and consistent improvement to application, selectivity, and matriculation rates. We would also view significant growth in available resources favorably.

Enterprise Profile

Industry risk

Industry risk addresses the higher education sector's overall cyclical 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 2018 students coming from Oregon. As a result, 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. The broad five-year trend indicates that enrollment has historically fluctuated around the 1,400 student level, with a low of 1,360 full-time-equivalent (FTE) students in fall 2014 and a high of 1,472 in fall 2018, representing an 8% increase. Management continues to be committed to maintaining 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. The college received 5,957 applications in fall 2018, representing a 5% increase from that of the prior year. Reed has undertaken several other initiatives related to recruitment including an early-action application, and collaborative recruitment travel with other liberal arts colleges that it considers peers such as Pomona College, Colorado College, and Swarthmore.

The college has maintained a good selectivity rate over the past few years, at 35% in fall 2018. The freshman retention rate for fall 2018 is good, at 88%, and close to rating category medians, although slightly down from a high 94% in fall 2013. The matriculation rate at Reed College has been gradually declining over the recent years, with fall 2018 matriculation of 17.4%. Management attributes this decreasing matriculation rate to a shift in the quality of students it attracts and the competing institutions to which they apply. Management stated one of its goals was to make Reed's facilities and offerings more attractive to students. Reed has recently added a Computer Science major and expanded faculty size in computer science, environmental studies, and chemistry, and is undertaking facilities upgrades to ensure a better student experience and to improve its matriculation rate.

Tuition is \$56,030 for the 2018-2019 school year, and has increased by an average of 4.2% per year over the past five academic years. These tuition increases have not had a material impact on enrollment. The overall tuition discount rate declined in fiscal 2018 to 35.5% from 38.9% in fiscal 2017. Management budgets for 35.8% in tuition discount rate for fiscal 2019. We view the college's ability to maintain a stable enrollment trend while moderating its tuition discount rate favorably.

Management and governance

After serving six years in the position, the college's former president resigned on June 30, 2018. The board formed a presidential search committee in June 2018, and the committee is actively engaging in the search for Reed's next president. During the interim, the former vice president of college relations, who has been long-tenured with the college, is serving as the acting president. The college is also in the process of appointing a new chief investment officer. The rest of the 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. We will continue to monitor the performance of the college and the stability of senior management team after the new president joins.

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 and boost fundraising through a prospective new capital campaign, and is currently bond financing the construction of residence halls with the series 2017A issuance to increase available student housing immediately around the college. In our view, the college has good management practices. We would view improvement in the matriculation rate as a result of these initiatives favorably.

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 with those of comparable providers.

Financial performance

Reed College continues to decrease its reliance on endowment spending in recent years in an effort to preserve its endowment. We note that the college has lowered its endowment spending rate by 15 basis points in the past two fiscal years, with an eventual goal of a 5.0% draw by fiscal 2021. We view this goal as manageable given Reed's strong demand, and its success in reducing the draw from 5.3% in fiscal 2014 to 5.15% in fiscal 2018. We consider the fiscal 2018 rate to be average. The draw is on a rolling 13-quarter average of fair value of the endowment.

Net tuition revenue has increased in every year since fiscal 2015, and grew in four of the five past fiscal years. Net tuition revenue rose by 12.3% during fiscal 2018 to about \$48 million, from \$43 million in the previous fiscal year. The college saw an improvement in its operations to a surplus of \$12.3 million (or a 10.1% margin) in fiscal 2018 from a surplus of \$5.9 million (or a 4.8% margin) in fiscal 2017. We note that, over the past five years, Reed has produced variable, though positive, margins. According to management's five-year financial model, Reed is projecting balanced operations throughout the period including absorbing net incremental costs of a new residence hall in fiscal 2020.

Available resources

At June 30, 2018, Reed College's available resources (as measured by expendable resources) grew by 12% from the previous year to \$438.6 million, which is mainly driven by investment return and gifts received during the fiscal year. This represents a good 3.6x operating expenses and 4.3x of outstanding debt. In our opinion, Reed College's available resource measures continue to be strong for the rating, though these ratios could become pressured over time if expendable resources decline or if Reed decides to issue additional debt.

Reed College's endowment returned approximately 9.2% in fiscal 2018, increasing to \$577 million as of June 30, 2018, and improved from \$555 million at June 30, 2017. As of Oct. 31, 2018, of a total \$564 million total portfolio market value, the allocation included 37% in equities, 22% in absolute return investments, 19% in private equity, 13% in real assets, and 9% in cash and fixed income. According to management's liquidity schedule, about 10% of total nonprivate investments were illiquid as of Sept. 26, 2018; 31% were available within one month; and 47% 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 \$26.4 million benefit obligation as of fiscal year-end 2018. We also note that the college has a good history of fundraising, with a fiscal 2018 alumni participation rate of 28%, and last finished a comprehensive capital campaign in 2012, raising \$200 million in gifts and pledges. The college is in the midst of a two-year initiative to raise \$50 million by June 30, 2020, having raised about 29% toward the goal. The college is also in the process of planning for the next capital campaign, the goal and timeline for which are expected to be finalized after the appointment of the new president.

Debt and contingent liabilities

As of June 30, 2018, Reed College's debt totaled \$102 million, approximately 36% of which consists of the series 2008A variable-rate debt, while the remaining 64% consists of the series 2017A fixed-rate debt. The series 2008A bonds are supported by an SBPA provided by Wells Fargo Bank N.A. expiring in January 2023.

The college has one interest rate swap with an outstanding notional amount of \$8.9 million; the mark-to-market value of the swap was a negative \$825,000 as of June 30, 2018. The college's debt service structure has debt service payments of about \$4.4 million in fiscal 2019 and steadily escalates to an estimated MADS of \$8 million in 2041, a structure that in our view limits the college's flexibility to issue additional debt. The debt burden when using MADS is 6.5%, which we consider above average, leaving little flexibility for additional debt. Reed College does not have any direct placement debt and does not have plans for any type of additional debt at this time.

Reed College, Oregon

Enterprise And Financial Statistics

	--Fiscal year ended June 30--					Medians for 'AA' rated Private Colleges & Universities
	2019	2018	2017	2016	2015	2017
Enrollment and demand						
Headcount	1,503	1,470	1,427	1,476	1,394	MNR
Full-time equivalent	1,472	1,432	1,397	1,416	1,360	6,335
Freshman acceptance rate (%)	35.0	35.6	31.3	35.0	38.7	25.3
Freshman matriculation rate (%)	17.4	20.5	19.9	22.3	22.7	MNR
Undergraduates as a % of total enrollment (%)	98.7	98.4	98.8	98.4	98.6	71.0
Freshman retention (%)	88.0	88.0	87.0	88.0	89.5	94.5
Graduation rates (six years) (%)	81.0	80.0	78.0	82.0	79.3	MNR
Income statement						
Adjusted operating revenue (\$000s)	N.A.	134,729	129,081	134,899	114,899	MNR
Adjusted operating expense (\$000s)	N.A.	122,423	123,161	120,368	110,862	MNR
Net operating income (\$000s)	N.A.	12,306	5,920	14,531	4,037	MNR
Net operating margin (%)	N.A.	10.05	4.81	12.07	3.64	2.02
Change in unrestricted net assets (\$000s)	N.A.	19,995	29,362	(55,431)	14,439	MNR
Tuition discount (%)	N.A.	35.3	38.9	38.6	37.9	38.0
Tuition dependence (%)	N.A.	55.4	54.5	50.4	54.2	MNR
Student dependence (%)	N.A.	66.5	65.6	61.0	66.0	58.9
Health care operations dependence (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Research dependence (%)	N.A.	1.0	1.0	1.6	1.7	MNR
Endowment and investment income dependence (%)	N.A.	20.6	21.4	19.3	21.1	MNR
Debt						
Outstanding debt (\$000s)	N.A.	101,995	77,790	79,240	80,644	356,370
Proposed debt (\$000s)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR

Reed College, Oregon (cont.)

Enterprise And Financial Statistics

	--Fiscal year ended June 30--					Medians for 'AA' rated Private Colleges & Universities
	2019	2018	2017	2016	2015	2017
Total pro forma debt (\$000s)	N.A.	101,995	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	2.88	2.96	2.83	3.03	MNR
Current MADS burden (%)	N.A.	6.53	5.68	5.82	6.32	4.00
Pro forma MADS burden (%)	N.A.	N.A.	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value (\$000s)	N.A.	555,583	516,219	484,078	534,814	1,461,237
Cash and investments (\$000s)	N.A.	639,593	604,124	552,557	588,695	MNR
Unrestricted net assets (\$000s)	N.A.	367,086	347,091	317,729	373,160	MNR
Expendable resources (\$000s)	N.A.	438,632	390,625	352,767	396,422	MNR
Cash and investments to operations (%)	N.A.	522.4	490.5	459.1	531.0	351.2
Cash and investments to debt (%)	N.A.	627.1	776.6	697.3	730.0	480.4
Cash and investments to pro forma debt (%)	N.A.	627.1	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	358.3	317.2	293.1	357.6	226.0
Expendable resources to debt (%)	N.A.	430.1	502.2	445.2	491.6	317.0
Expendable resources to pro forma debt (%)	N.A.	430.1	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	17.8	17.1	16.9	16.0	13.7

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 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.

This report does not constitute a rating action.

Ratings Detail (As Of January 30, 2019)

Oregon Facs Auth, Oregon

Reed Coll, Oregon

Oregon Fac Auth rev bnds (Reed Coll Proj) 2008 ser A

Long Term Rating

AA-/A-1/Stable

Current

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