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Ratings

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

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Oregon Facilities Authority
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Credit Profile		
US$68.000 mil rev and rfdg bnds (Reed Coll) (New Residence Hall & Ser 2011A Rfdg) ser2017A dtd 12/5/2017 due 7/1/2047		
Long Term Rating	AA-/Stable	New
Oregon Facs Auth, Oregon		
Reed Coll, Oregon		
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

S&P Global Ratings assigned its 'AA-' long-term rating to the Oregon Facilities Authority's series 2017A revenue bonds, issued for Reed College. The outlook is stable.

S&P Global Ratings also affirmed its 'AA-/A-1+' rating on the series 2008 bonds and its 'AA-' rating on the series 2011 bonds, which will be refunded with the series 2017A bond proceeds. All bonds were issued for Reed College, and the outlook remains stable.

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 and stable management team. We assessed Reed's financial profile as very strong, with consistently positive operating performance, acceptable expendable resource ratios for the rating even when incorporating additional debt, moderate dependence on student and endowment revenues, and above-average pro forma 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 Reed College's:

- Consistently positive operating margins, with fiscal 2017 producing a solid, 7.5% operating margin;
- Robust balance sheet for the rating category, with fiscal 2017 expendable resources equal to 3.25x of annual operating expenses and 3.7x of pro forma debt; and
- Experienced and stable 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 relatively stagnant matriculation rate of about 20% over the past two fiscal years;
- Above-average pro forma MADS burden of 6.7%; and
- Average endowment draw of 5.2% in fiscal 2017, 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.

After the series 2017A issuance, Reed College's debt will total $105.8 million, approximately 36%, or $37.8 million, of which will consist of the series 2008A variable-rate debt, while the remaining 64%, or $68.0 million, will consist of the series 2017A fixed-rate debt. The series 2017A bond proceeds will be used to fully refund the series 2011 bonds for savings and also provide about $28 million in new money to construct a 180-bed residence hall on the Reed campus. The series 2017A bonds are issued on parity with the series 2008 and series 2011 bonds. Pro forma debt service begins at about $5.6 million in fiscal 2019 and steadily escalates to an estimated MADS of $7.9 million in 2042.

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 2017, 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 financial resources.

Downside scenario

We could take a negative rating action if enrollment or matriculation declines significantly, if the college issues debt such that it begins to pressure the MADS burden or financial 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 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 2017 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 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 1,432 in fall 2017. Over a five-year period, FTE students have increased modestly by about 4%, and management has stated that, going forward, it is 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. Total applications in fall 2017 were relatively static compared to fall 2016, at 5,652, but increased substantially, by 95%, over a five-year period. Management attributes this significant increase in applications over a five-year period to its increased marketing efforts and more broadly to its participation as a founding member in the Coalition for Access, Affordability, and Success, which currently has 113 member institutions. Reed has also 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 become increasingly selective over the past several years; the acceptance rate improved significantly over a five-year period to 35.6% in fall 2017 from 48.5% in fall 2013. The freshman retention rate fall 2017 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 relatively flat over the past year, with fall 2017 matriculation of 20.5%. 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 its 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 $53,900 for the 2017-2018 school year, and has increased by an average of 4% per year over the past five fiscal years. These tuition increases have not had a material impact on enrollment. The overall tuition discount rate was relatively static at 38.9% in fall 2017, which is a modest increase from 38.6% in the previous school year. Management reports that for fall 2018, the freshman discount rate dropped to 34%, which it attributes to its new targeted financial aid model.

Management and governance

The college's management and board leadership has been relatively stable. The team has significant continuity and experience and has had very few management changes over the past year. The college is governed by a self-perpetuating board of trustees that consists of at least 30 members.

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.

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 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 draw by 10 basis points in the past two fiscal years and plans to drop the draw to 5.15% during fiscal 2018, 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 5.2% in fiscal 2017. We consider the fiscal 2017 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 3.0% during fiscal 2017 to about $43.0 million, from $41.7 million in the previous fiscal year. 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 $9.0 million, or 7.5% of operations, in fiscal 2017, its second-highest operating margin in the past five fiscal years, down from a peak margin of 12.1% in fiscal 2016. Management attributes this decline partly to variance in auxiliary revenues related to dining. 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 targeting for positive operations on a budgetary basis with a $1 million surplus that will help to support the residence hall.

Available resources

At June 30, 2017, Reed College's available resources (as measured by expendable resources) increased for the first time after two fiscal years of decline. Management attributes this growth to strong, roughly 12.4% growth in its investment portfolio. Fiscal 2017 expendable resources equaled an improved, and still good, 3.25x operating expenses and an adequate 3.7x pro forma 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 12.4% in fiscal 2017, increasing to $555 million as of June 30, 2017, and improved from $498 million at June 30, 2016. As of September 30, 2017 of a total $555 million total portfolio market value, the allocation included 33% in equities, 25% in absolute return investments, 17% in private equity, 12% in real assets, and 10% in cash and fixed income. According to management's liquidity schedule, about 31% of total investments were illiquid as of Sept. 30, 2017; 19% were available within one month; and 32% 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 $26.6 million benefit obligation as of fiscal year-end 2017.We also note that the college has a good history of fundraising, with a fiscal 2017 alumni participation rate of 31.5%, 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 but still manages to raise funds in the absence of a campaign. Management notes that in fiscal 2017, fundraising generated over $18.8 million in cash.

Debt and contingent liabilities

After issuance, Reed College's debt will total $105.8 million, approximately 36% of which will consist of the series 2008A variable-rate debt, while the remaining 64% consist 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 June 2018, though we note that the college already has a commitment letter from Wells Fargo to extend the facility by five years. The series 2017A bonds will refund the series 2011 bonds and will also provide approximately $28 million in new money for the construction of a 180-bed, LEED Platinum-certified residence hall.

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 $1.3 million as of June 30, 2017. Postissuance, the college's debt service structure begins with debt service payments of around $5.6 million in fiscal 2019 and steadily escalates to an estimated MADS of $87.9 million in 2042, a structure that in our view limits the college's flexibility to issue additional debt. The debt burden when using MADS of $7.9 million (occurring in 2042) is 6.7%, 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
	2018	**2017**	**2016**	**2015**	**2014**	**2016**
Enrollment and demand						
Headcount	1,470	1,427	1,476	1,394	1,411	MNR
Full-time equivalent	1,432	1,397	1,416	1,360	1,378	6,253
Freshman acceptance rate (%)	35.6	31.3	35.0	38.7	48.5	25.7
Freshman matriculation rate (%)	20.5	19.9	22.3	22.7	25.4	MNR
Undergraduates as a % of total enrollment (%)	98.4	98.8	98.4	98.6	98.9	71.9
Freshman retention (%)	88.0	87.0	88.0	89.5	94.1	94.8
Graduation rates (six years) (%)	80.0	78.0	82.0	79.3	81.9	MNR

Reed College, Oregon (cont.)

Enterprise And Financial Statistics

	--Fiscal year ended June 30--					Medians for 'AA' rated Private Colleges & Universities
	2018	2017	2016	2015	2014	2016
Income statement						
Adjusted operating revenue ($000s)	N.A.	129,081	134,899	114,899	114,222	MNR
Adjusted operating expense ($000s)	N.A.	120,066	120,368	110,862	107,605	MNR
Net operating income ($000s)	N.A.	9,015	14,531	4,037	6,617	MNR
Net operating margin (%)	N.A.	7.51	12.07	3.64	6.15	1.59
Change in unrestricted net assets ($000s)	N.A.	29,362	(55,431)	14,439	40,507	MNR
Tuition discount (%)	N.A.	38.9	38.6	37.9	36.7	37.1
Tuition dependence (%)	N.A.	54.5	50.4	54.2	54.4	MNR
Student dependence (%)	N.A.	65.6	61.0	66.0	66.0	60.0
Research dependence (%)	N.A.	1.0	1.6	1.7	1.1	MNR
Endowment and investment income dependence (%)	N.A.	21.4	19.3	21.1	20.1	MNR
Debt						
Outstanding debt ($000s)	N.A.	77,790	79,240	80,644	81,873	305,339
Proposed debt ($000s)	N.A.	28,000	N.A.	N.A.	N.A.	MNR
Total pro forma debt ($000s)	N.A.	105,790	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	7,900	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	3.04	2.83	3.03	4.21	MNR
Current MADS burden (%)	N.A.	5.83	5.82	6.32	6.51	5.53
Pro forma MADS burden (%)	N.A.	6.58	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value ($000s)	N.A.	N.A.	484,078	534,814	550,483	1,132,510
Cash and investments ($000s)	N.A.	604,124	552,557	588,695	589,544	MNR
Unrestricted net assets ($000s)	N.A.	347,091	317,729	373,160	358,721	MNR
Expendable resources ($000s)	N.A.	390,625	352,767	396,422	397,313	MNR
Cash and investments to operations (%)	N.A.	503.2	459.1	531.0	547.9	331.4
Cash and investments to debt (%)	N.A.	776.6	697.3	730.0	720.1	446.5
Cash and investments to pro forma debt (%)	N.A.	571.1	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	325.3	293.1	357.6	369.2	202.5
Expendable resources to debt (%)	N.A.	502.2	445.2	491.6	485.3	274.9
Expendable resources to pro forma debt (%)	N.A.	369.2	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	17.1	16.9	16.0	17.6	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.