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Reed College, Oregon; Private Coll/Univ - General Obligation

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Reed College, Oregon; Private Coll/Univ - General Obligation

Credit Profile

US\$125.0 mil taxable fixed rate bnds ser 2022A due 07/01/2052

<i>Long Term Rating</i>	AA-/Stable	New
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Oregon Facs Auth, Oregon

Reed Coll, Oregon

Oregon Facs Auth (Reed Coll) PCU_GO

<i>Long Term Rating</i>	AA-/Stable	Affirmed
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Oregon Facs Auth (Reed Coll) PCU_GO

<i>Long Term Rating</i>	AA-/A-1/Stable	Affirmed
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Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Reed College, Ore.'s series 2022A taxable fixed-rate bonds. At the same time, S&P Global Ratings affirmed its 'AA-' long-term rating on the Oregon Facilities Authority's series 2017A revenue bonds, issued for Reed College, and affirmed the 'AA-' long-term component and the 'A-1' short-term component of the rating on Reed's series 2008 bonds. The short-term rating on the series 2008 bonds reflects a standby bond purchase agreement provided by Wells Fargo Bank N.A. expiring in January 2023. The outlook on all long-term ratings is stable.

Reed is issuing approximately \$125 million of 30-year, fixed-rate, taxable bonds with a bullet maturity. The bonds are a general obligation of the college. Approximately \$109.5 million will be used to refund the series 2008A and 2017A bonds, and \$15.5 million will be used for general corporate purposes including covering the cost of unwinding the swap associated with the 2008A bonds. Following the refunding, total pro forma debt will be approximately \$125 million. In addition to the college's outstanding bonds, Reed has a lease liability of approximately \$500,000. While the college's total debt load will remain relatively low compared with that of similarly rated peers, we view the smoothed pro forma maximum annual debt service (MADS) burden of 6.1% as above average for the rating category. Management does not expect to issue any additional debt within the outlook period.

Reed returned to fully in-person operations in fall 2021. In order to lessen the spread of COVID-19, the college required students to be vaccinated and to follow other health and safety protocols as required by the state of Oregon. Following a drop in enrollment in fall 2020, demand demonstrated a strong recovery. Full-time-equivalent (FTE) enrollment grew 13% to 1,532. This is larger than management's target size for the school, so we do not expect continued growth on this scale. However, we believe the rebound in enrollment is indicative of the school's attractive niche. Management report applications for fall 2022 are currently tracking ahead of last year's results. The college ended fiscal year 2021 with a surplus of 2.4%, continuing a trend of positive operations. We expect another surplus in fiscal 2022. The college was awarded a total of \$2.3 million in institutional relief funding, of which \$1.1 million is available for use in fiscal 2022.

Credit overview

We assessed Reed's enterprise profile as very strong, characterized by above-average student quality and a sound management team, offset by relatively weak and deteriorating selectivity. We assessed Reed's financial profile as very strong, with a track record of healthy operating margins, robust expendable resource ratios for the rating, moderate dependence on student and endowment revenues, and an above-average MADS burden. We believe these credit factors, combined, 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 another surplus expected in fiscal 2022;
- Robust balance sheet for the rating, with fiscal 2021 expendable resources equal to 4.6x annual operating expenses and 4.9x pro forma debt; and
- Skilled management team that has continued to attract and retain quality students, including during the pandemic.

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 low matriculation rate, and
- Above-average pro forma MADS burden of 6.1%.

The stable outlook reflects our expectation that Reed will maintain an attractive liberal arts niche that supports enrollment around its target size of 1,400 FTE students, while generating full-accrual operating surpluses and growing available resources.

Founded in 1908, Reed College is a liberal arts institution that attracts high-quality undergraduate students from across the U.S. and internationally. The college is located on a partially wooded 116-acre campus five miles from downtown Portland, Ore. 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.

Environment, social, and governance

In our view, the higher education sector continues to face elevated social risks due to the health and safety issues created by COVID-19, particularly with the emergence of new variants. However, we believe that Reed has taken steps to protect students by requiring vaccination and following other health and safety protocols as required by the state of Oregon. We believe the college's environmental and governance risks are in line with those of the sector as a whole.

Stable Outlook

Upside scenario

We could consider a positive rating action if the college improves its demand profile, particularly selectivity, graduation, or matriculation rates, while maintaining healthy operating margins and growing available resources.

Downside scenario

We could consider a negative rating action if the college's demand metrics, particularly selectivity, matriculation, and retention, declined materially. While not expected in the outlook period, we could also consider a negative rating action if the college issued additional debt without commensurate growth in balance sheet resources.

Credit Opinion

Enterprise Profile

Market position and demand

Historically, Reed's enrollment has been relatively stable and slightly above its target size of 1,400 FTE students. Following a 6% drop in fall 2020, FTE enrollment recovered an impressive 13% in fall 2021 to 1,532 students. Given management's commitment to maintaining a close-knit campus culture and a low student-faculty ratio of 9.4 to 1, we do not expect continued growth in enrollment. Reed continues to compete for high-quality students both nationally and internationally. More than 90% of students come from out of state. Reed was test-blind for the fall 2021 admissions cycle, and as was the case for other top liberal arts schools, this contributed to a large increase in applications. Applications increased by 24%, and management reports continued strong growth year-over-year for fall 2022. Reed has undertaken several initiatives related to recruitment including an early-action application and increased virtual programming.

The college's selectivity rate has weakened over the past few years to 44% in fall 2021. Matriculation remains low but improved slightly in fall 2021 to 16%. Management attributes lower matriculation to a shift in the quality of students it attracts and the competing institutions to which they apply. However, there are plans in place to increase yield, including more personalized outreach to admitted students. The freshman retention rate for fall 2021 was good at 87%, although below the rating category median. Management recently expanded the on-campus residency requirement to sophomores, which may support improvement in retention and graduation rates.

Tuition is \$62,420 for the 2021-2022 school year and has increased by about 3.5%-4.0% annually. The discount rate increased slightly to 37% in fiscal 2021, which is low compared with that of peers. We view the college's ability to maintain a relatively stable enrollment trend while moderating its tuition discount rate favorably.

Management and governance

Audrey Bilger has served as Reed's president since July 2019. A new vice president of finance and treasurer joined the college in summer 2021. The college is currently looking for a dean of institutional diversity. 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.

Reed incorporates identified strategic priorities into annual departmental plans, budget models, and fundraising initiatives. The college is currently crafting its next strategic plan and fundraising campaign. We would view improvement in the selectivity and matriculation rates as a result of the college's strategic initiatives favorably.

Reed College has formal policies for endowment, investments, and debt. Reed also has a formal endowment liquidity

policy and meets standard annual disclosure requirements.

Financial Profile

Financial performance

Reed has a track record of positive full-accrual operations, and this continued in fiscal 2021 with a surplus of \$3.2 million, or 2.4% of fiscal 2021 adjusted operating expenses. While net tuition revenue and auxiliary revenue fell, the college achieved a surplus thanks to cost containment measures and federal relief funds. Student-derived revenues from tuition and auxiliaries make up approximately 66% of total adjusted operating revenue, which is lower than that of many similarly sized liberal arts institutions. Reed expects to generate another full-accrual operating surplus in fiscal 2022. Conservative budgets and consistent surpluses have supported growth in the college's available resources, which we view favorably.

Available resources

Like many colleges and universities, Reed saw excellent growth in available resources in fiscal 2021 thanks to strong market returns. Cash and investments grew 33% to \$862.6 million. Expendable resources grew over 50% to \$608.8 million, representing 4.6x operating expenses and 4.9x pro forma debt. To calculate expendable resources, we use net assets "without donor restrictions" instead of the formerly classified unrestricted net assets. We also factor in \$199.9 million of net assets "with donor restrictions" that would have been classified as "temporarily restricted net assets" under the old FASB standards for comparability purposes. In our opinion, Reed College's available resource measures continue to be strong for the rating.

Reed College's endowment net assets grew an impressive 39.5% to \$747.2 million in fiscal 2021. According to management's liquidity schedule, about 17% of total nonprivate investments were liquid weekly, 51% were available within one month, and 89% were available within three months.

We also note that the college has a good history of fundraising, with alumni participation of around 25%. The college raised over \$5 million in annual fund gifts in fiscal 2021. We expect fiscal 2022 will yield solid results as well. In December 2020, the college closed a short-term, two-year campaign exceeding its goal of \$50 million. Reed expects to launch its next fundraising campaign with its next strategic plan.

Debt and contingent liabilities

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 \$31.3 million benefit obligation as of fiscal year-end 2021.

As of June 30, 2021, Reed has one interest rate swap with an outstanding notional amount of \$6.6 million and a mark-to-market value of negative \$605,000. This swap will be eliminated using the proceeds of the 2022 series bonds.

In addition to refunding the series 2008A and 2017A bonds, a portion of the 2022 bonds will be used, along with insurance proceeds, to rebuild gyms that were destroyed in an ice storm in February 2021. To prepare for the bullet maturity associated with the 2022 bonds, the college will use an internal amortization program with annual reporting to the board during the life of the bonds. Reed College does not have any direct placement debt and does not have

plans for any type of additional debt at this time. A library renovation that began in December 2021 is being funded through bequests and operating surpluses.

	--Fiscal year ended June 30--					Medians for 'AA' rated private colleges & universities
	2022	2021	2020	2019	2018	2020
Enrollment and demand						
Headcount	1,566	1,385	1,471	1,503	1,470	MNR
Full-time equivalent	1,532	1,355	1,440	1,472	1,432	8,288
Freshman acceptance rate (%)	43.8	42.3	39.5	35.0	35.6	18.0
Freshman matriculation rate (%)	16.3	15.4	17.2	17.4	20.5	MNR
Undergraduates as a % of total enrollment (%)	98.9	98.6	99.0	98.7	98.4	65.1
Freshman retention (%)	87.0	83.0	91.0	88.0	88.0	95.0
Graduation rates (six years) (%)	73.0	77.0	76.0	81.0	80.0	MNR
Income statement						
Adjusted operating revenue (\$000s)	N.A.	136,051	140,209	136,718	135,454	MNR
Adjusted operating expense (\$000s)	N.A.	132,828	132,001	127,896	123,148	MNR
Net operating income (\$000s)	N.A.	3,223	8,208	8,822	12,306	MNR
Net operating margin (%)	N.A.	2.43	6.22	6.90	9.99	1.20
Change in unrestricted net assets (\$000s)	N.A.	109,019	(6,444)	(911)	20,295	MNR
Tuition discount (%)	N.A.	37.4	35.7	35.9	35.3	39.4
Tuition dependence (%)	N.A.	58.7	58.7	59.1	55.1	MNR
Student dependence (%)	N.A.	66.2	68.1	70.1	66.1	59.4
Research dependence (%)	N.A.	2.2	1.3	1.1	0.9	MNR
Endowment and investment income dependence (%)	N.A.	21.2	20.6	21.1	20.5	MNR
Debt						
Outstanding debt (\$000s)	N.A.	97,400	98,995	100,530	101,995	540,885
Total pro forma debt (\$000s)	N.A.	125,000	N.A.	N.A.	N.A.	MNR
Pro forma MADS	N.A.	8,079	N.A.	N.A.	N.A.	MNR
Current debt service burden (%)	N.A.	3.45	3.74	3.89	2.86	MNR
Current MADS burden (%)	N.A.	6.02	6.06	6.26	6.50	4.20
Pro forma MADS burden (%)	N.A.	6.08	N.A.	N.A.	N.A.	MNR
Financial resource ratios						
Endowment market value (\$000s)	N.A.	747,245	569,284	579,820	577,790	1,922,226
Cash and investments (\$000s)	N.A.	862,608	650,114	651,237	639,593	MNR
Unrestricted net assets (\$000s)	N.A.	469,050	360,031	366,475	367,386	MNR
Expendable resources (\$000s)	N.A.	608,751	404,149	416,062	438,632	MNR
Cash and investments to operations (%)	N.A.	649.4	492.5	509.2	519.4	338.3
Cash and investments to debt (%)	N.A.	885.6	656.7	647.8	627.1	447.8

Reed College, Oregon--Enterprise And Financial Statistics (cont.)

	--Fiscal year ended June 30--					Medians for 'AA' rated private colleges & universities
	2022	2021	2020	2019	2018	2020
Cash and investments to pro forma debt (%)	N.A.	690.1	N.A.	N.A.	N.A.	MNR
Expendable resources to operations (%)	N.A.	458.3	306.2	325.3	356.2	185.4
Expendable resources to debt (%)	N.A.	625.0	408.3	413.9	430.1	261.5
Expendable resources to pro forma debt (%)	N.A.	487.0	N.A.	N.A.	N.A.	MNR
Average age of plant (years)	N.A.	18.4	17.8	18.8	17.4	13.9

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.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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