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

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Credit Profile		
US$40.119 mil rev bnds (Reed Coll) ser 2011A due 06/30/2042		
Long Term Rating	AA-/Stable	New
Oregon Fac Auth, Oregon		
Reed Coll, Oregon		
Oregon Fac Auth (Reed College), rev bnds, ser 2000A		
Long Term Rating	AA-/Stable	Outlook Revised
Oregon Fac Auth (Reed Coll) rfdg bnds (Reed Coll) ser 2008		
Long Term Rating	AA-/A-1+/Stable	Outlook Revised

Rationale

Standard & Poor's Ratings Services revised the long-term rating outlook to stable from positive on Oregon Facilities Authority's outstanding revenue bonds issued for Reed College. We also affirmed our 'AA-/A-1+' and 'AA-' ratings on the authority's debt issued for the college. The short-term component of the rating reflects a standby bond purchase agreement (SBPA) provided by Wells Fargo Bank National Association. The outlook revision is based on our view of Reed's declining applications, increasing debt service requirements, and reliance on its endowment. Finally, Standard & Poor's assigned its 'AA-' rating to the authority's series 2011A revenue bonds, issued on behalf of the college.

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

- Solid balance sheet for the rating category, with an endowment of about $387 million as of Sept. 30, 2010, that supports good financial resources, as demonstrated by fiscal 2010 expendable resources equal to 3.7x of annual operating expenses and more than 3x of pro forma debt;
- Historical break-even operations, with a modest adjusted operating surplus of $2 million in fiscal 2010;
- Good history of fundraising, with annual giving of more than $3 million in 2010 and an alumni participation rate of just over 30%; and
- Stable enrollment.

The preceding credit strengths are offset in part by our view of:

- The college's strong competition for students, as demonstrated by a decrease in freshman applications during the last two years;
- The college's high reliance on investment returns for operating performance (about 30% of budget) and historically aggressive portfolio mix; and
- An increase in preliminary aggregate debt service to $6.9 million in 2042 from $4.4 million in 2012, with a high

7.6% maximum annual debt service (MADS) debt burden based on 2010 operating expenses, which indicates reliance on continued budget and enrollment growth.

Proceeds of the series 2011A bonds will be used to construct a new performing arts building ($20.3 million) and refund the series 2000 bonds ($19.8 million). The bonds are a general obligation of the college issued on parity with outstanding debt. Total debt following this issue will be $86.5 million, just over half of which is variable-rate debt (series 2008: $46.7 million). The SBPA related to the series 2008 variable-rate demand bonds is due to expire in April 2011. Post-issuance, the college's debt structure will steadily escalate, to an estimated $6.9 million in 2042 from $4.4 million in 2012, a structure that in our view limits flexibility for additional debt. The debt burden, using near-term average debt service of $4.75 million and adjusted audited operating expenses in 2010, is 5.2% and is a much higher 7.6% using MADS of $6.9 million (occurring in 2042).

Founded in 1908, Reed College is a liberal-arts institution that attracts high-quality undergraduate students from across the U.S. Student quality is shown by strong freshman average SAT scores (mathematics and critical reading) of 1380 and 1387, respectively, in fall 2010. Reed shares student cross-applications and admissions with institutions such as Brown University, R.I., Oberlin College, Ohio, Swarthmore College, Pa., Pomona College, Calif., and Wesleyan University, Conn. Reed has maintained stable enrollment, and headcount totaled 1,477 for fall 2010 (about the average over the last four years) despite strong competition from these and other schools and declining applications.

Outlook

The stable outlook reflects our expectation that in the next two years, the college will produce positive operating margins on a full-accrual basis, have stable enrollment, and maintain its solid financial resource ratios relative to the rating category. We expect the college to grow into its MADS debt burden over time.

Pressure on the rating or outlook could come from enrollment declines, issuance of significant new debt without growth in revenues or resources, or operating deficits.

Consideration of a positive rating action in the outlook period would require solid operating margins, a manageable MADS burden, improvement in the college's demand metrics, stable enrollment, and maintenance of financial resource ratios relative to the rating category.

Demand

Freshman applications had been growing steadily but dipped for two consecutive years in fall 2009 and fall 2010, which management attributes to the economic downturn and to a transition in the dean of admissions position. Reed received 3,161 applications for fall 2009, a 9% decrease from 2008. In fall 2010, applications further declined 3% to 3,075. While overall selectivity remains strong relative to peer institutions, Reed's freshman acceptance rates weakened in the last two years to 41% in fall 2009 and 43% in fall 2010 (compared with 34% and 33% in fall 2007 and fall 2008, respectively). We will continue to observe the demand and selectivity data for the college. Despite the weaker application and selectivity, enrollment has been stable, and freshman matriculation rates have remained at around 29%. Reed continues to compete for high-quality students on a national and regional basis. Reed attracts students from throughout the nation, and more than 80% of students come from outside of Oregon. The freshman-sophomore retention rate is, in our view, very good, at around 90%. Tuition was $40,940 for the

2010-2011 school year; it will be raised 3.8% for fall 2011, according to management. The overall tuition discount rate was 35% in fiscal 2010.

Operations

With an endowment of $387 million as of September 2010, Reed's budget is highly reliant on endowment-generated revenue, with endowment spending accounting for 29% of fiscal 2010 revenues, or about $19.6 million. The endowment was $366 million at fiscal year-end; and was estimated at $387 million at Sept. 30, 2010. Because the college has an annual spending rate of 5.3% on a rolling 13-quarter average, a rate that we consider to be somewhat above average, management is aware that it may face budgetary challenges as the funding formula results in lower spendable draws due to prior weak quarters during the recession. Management has indicated that it is saving surpluses to cover for possible operating shortfalls.

The college achieved modest surpluses on a budgetary basis in fiscals 2009 and 2010. Management expects operational performance to be break-even in fiscal 2011. On an audited basis, we calculate operating performance by adjusting unrealized/realized gains and losses in investments. However, as Reed accounts for a significant portion of its annual endowment spending in the gains/losses line, we included a portion in the calculation of operating performance. With this adjustment, the college had an operating surplus of about $2 million in fiscal 2010. Without this adjustment, the college had a deficit of $1.2 million in fiscal 2010. Our adjusted operating surplus estimate may be overstated in fiscal 2010, as well as fiscals 2009 and 2008, as the college is in a campaign and received higher levels of gifts than prior years, some of which were likely used for nonoperating projects.

Financial Resources

At June 30, 2010, Reed's financial resources ratios were, in our opinion, strong for the rating category, with expendable resources of $270 million equal to 3.7x of expenses and pro forma debt by more than 3x. Cash and investments (which include restricted endowment) are, in our view, even stronger, at $407 million, equal to 5x pro forma debt.

Fundraising/Endowment

Fundraising is strong at the college: annual fund donations totaled $3 million in fiscal 2010, a 23% increase from the previous year. The last capital campaign ended in 2000 and raised $113 million, well above the goal of $80 million. Management reports there is a new campaign underway, and $150 million of the $200 million goal has been raised in cash or pledges.

After declining by 3% and 26% in fiscals 2008 and 2009 (consistent with the general financial markets), Reed's endowment increased 13% to $365.6 million in fiscal 2010. The asset allocation has been diversifying but remains, our view, somewhat aggressive. The allocation as of September 2010 is 36% in absolute return investments, 24% in equities, 11% in real assets, 17% in private equity, and 12% in cash or fixed income.

Debt Derivative Profile (DDP)

In conjunction with the series 2006 bonds, Reed entered into an amortizing $16.65 million floating-to-fixed rate swap contract with UBS (A+) as counterparty. This swap is Reed's only outstanding debt derivative contract. The college has been assigned a Standard & Poor's Debt Derivative Profile (DDP) score of '2' on a four-point scale, where '1' represents the lowest risk. In our view, the swap program poses low to moderate risk to Reed's credit quality due to a structure that is well matched to the underlying debt, a highly rated counterparty, and Reed's ability to cover any collateral postings. As of September 2010, the contract's mark-to-market value was a liability of $1.2 million. The college reports that it has not had to post collateral.

Related Criteria And Research

- USPF Criteria: Higher Education, June 19, 2007
- USPF Criteria: Debt Derivative Profile Scores, March 27, 2006

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