

MOODY'S

INVESTORS SERVICE

CREDIT OPINION

7 December 2017

New Issue

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The Hill School, PA

New Issue - Moody's assigns A1 to The Hill School's (PA) series 2017 bonds; outlook stable

Summary Rating Rationale

Moody's Investors Service has assigned an A1 to The Hill School's (PA) proposed approximately \$18 million Revenue Bonds (The Hill School Project) Series of 2017, to be issued through Montgomery County Higher Education and Health Authority (PA). The proposed bonds will be fixed rate with a final maturity in 2050. We also maintain an A1 rating on the school's series 2015 bonds. The outlook is stable.

The A1 reflects Hill's stable student demand evidenced by strong net tuition per student, healthy philanthropic support, and sound financial resources relative to debt and operations. Offsetting credit considerations include the school's small scope of operations and thin operating performance.

Credit Strengths

- » Established brand as a selective independent day and boarding school evidenced by admission of only 30% of applicants while yielding a healthy 58% of those admitted
- » Good cushion of reserves, with fiscal 2017 expendable financial resources covering annual operating expenses 3.4 times
- » Stable philanthropic support with three-year (fiscal 2015-17) average gift support of \$12 million

Credit Challenges

- » Facilities capacity constraints limit potential for enrollment growth
- » Increasing focus on affordability may suppress tuition revenue growth
- » Small scale of operations exposes the school to potential operating volatility

Rating Outlook

The stable outlook reflects our expectation of continued strong student demand, improving philanthropic support and Hill's ability to continue to effectively manage expenditures.

Factors that Could Lead to an Upgrade

- » Substantial growth in financial resources providing increased support for operations
- » Improved and sustained maintenance of operating performance

Factors that Could Lead to a Downgrade

- » Significant deterioration of financial reserves or liquidity
- » Increase in debt without growth in financial resources or revenue
- » Softening of market position leading to weakening of operating performance

Key Indicators

Exhibit 1

THE HILL SCHOOL, PA

	2013	2014	2015	2016	2017	2017 Pro forma
Total FTE Enrollment	504	515	502	522	522	522
Operating Revenue (\$000)	28,116	29,813	31,927	31,820	33,889	33,889
Annual Change in Operating Revenue (%)	8.2	6.0	7.1	-0.3	6.5	6.5
Total Cash & Investments (\$000)	138,291	166,712	164,475	158,582	175,824	175,824
Expendable Financial Resources (\$000)	92,480	108,594	108,412	98,584	112,060	112,060
Total Debt (\$000)	32,911	35,136	55,017	33,312	32,367	38,053
Expendable Financial Resources to Total Debt (x)	2.8	3.1	2.0	3.0	3.5	2.9
Expendable Financial Resources to Operating Expenses (x)	3.4	3.7	3.5	3.1	3.4	3.4
Monthly Days Cash on Hand (x)	661	655	626	591	602	602
Operating Cash Flow Margin (%)	13.9	15.4	17.3	13.7	15.4	15.4
Total Debt to Cash Flow (x)	8.4	7.7	10.0	7.6	6.2	7.3
Annual Debt Service Coverage (x)	3.2	3.2	4.1	3.4	2.7	2.0

Pro forma column includes estimated impact of new issuance and uses estimated fiscal 2019 debt service.

Fiscal 2015 total debt includes series 2015 bonds, the proceeds of which were used to refund the series 2005 bonds in fiscal 2016.

Source: Moody's Investors Service

Detailed Rating Considerations

Market Profile: Stable market position with enrollment growth limited by campus size

Hill's strong reputation as a highly selective independent school will continue to support its desirable market position. Robust student demand is reflected by a high 58% yield on incoming fall 2017 students despite operating in a highly competitive market. Hill draws students from a range of geographies both domestically and internationally and has strong pricing power evidenced by fiscal 2017 net tuition per student growing 3% to \$37,338.

Hill benefits from being a predominantly boarding school which limits the impact of potential downturns in the local economy. The school has grown its admissions staff to more aggressively target students outside of the mid-atlantic U.S. To maintain affordability and price competitiveness, the school's annual tuition increases have been held to 2% since fall 2015. Due to capacity constraints, Hill's target enrollment size is approximately 500 full-time equivalent students (FTEs) however, Hill has been over capacity the past few years with fall 2016 and 2017 enrollment at 522 FTEs.

Continuous investment in capital facilities and programmatic initiatives enhances Hill's market appeal; the school's age of plant is a favorable 8.6 years. The school has made investments in its math and engineering curriculum and plans to open a science, technology, engineering and mathematics (STEM) complex, funded with gifts, by fall 2020. Hill recently announced the creation of a charitable entity tasked with community development projects which will support the school's engagement with local stakeholders.

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Operating Performance: Prudent budget oversight with thin operating performance

Management's conservative budgeting and fiscal oversight, coupled with healthy demand, support our expectation for stable operating performance. While Hill has had thin operating margins, the school maintains some expense flexibility and budgets for contingencies which helps mitigate some operational volatility given Hill's relatively small scope of operations. Fiscal 2016 operating margins were -1.1% but improved in fiscal 2017 to 2%. Favorably, cash flow generation has been strong averaging 15% since fiscal 2013. The school has raised compensation and benefits for its faculty and staff, partially funded by endowed gifts and not filling open positions. Maintaining and growing donor support, representing 15% of fiscal 2017 operating revenue, will remain vital given Hill's focus on tuition affordability and limited capacity to increase enrollment.

Wealth and Liquidity: Strong wealth provides adequate cushion to debt and operations

Hill's wealth is strong relative to its enrollment, operations, and debt burden. Since fiscal 2013, stewardship of the endowment and stable gift revenue has led to 27% growth in total cash and investments to \$175 million as of fiscal end 2017 (June 30, 2017). Expendable financial resources covered debt an adequate 3.5 times in fiscal 2017 and on a pro forma basis covers debt 2.9 times.

Hill's \$170 million endowment (as of 10/31/17) is overseen by the board of director's investment committee which is responsible for asset allocation. An external consultant aids in the vetting of investment managers and provides investment recommendations to the school. The endowment returned a strong 14.1% in fiscal 2017 and is heavily weighted towards public equities (approximately 60%). The school has grown its advancement staff in order to improve gift receipts and bolster its donor base. Hill is in the midst of a comprehensive fundraising campaign towards which approximately 60% has been raised.

LIQUIDITY

Hill's monthly liquidity of \$49 million at June 30, 2017, provided a strong 602 monthly days cash on hand, enhancing financial flexibility. The school's high liquidity provides adequate coverage of \$22 million in unfunded portfolio commitments. The school also maintains a \$2 million line of credit which it has drawn on infrequently.

Leverage: Manageable leverage with limited future borrowing

Hill's leverage will remain manageable with limited debt plans and stable wealth accumulation. The school has no near term plans for additional debt outside of the proposed series 2017 issuance and a potential bridge loan that would be serviced with gifts pledged towards a dining hall renovation. Debt to operating revenue was 1.0 times at fiscal end 2017 and will rise modestly to 1.1 times on a pro forma basis incorporating the new issuance.

DEBT STRUCTURE

The school's total \$33 million debt outstanding at fiscal end 2017 was comprised of a mix of fixed and variable rate debt. Unrated series 2002 bonds, were originally issued as variable rate and are now fixed rate and bank placed. Unrated series 2008 is a variable rate construction note with [M&T Bank](#). Both series 2002 and series 2008 are expected to be refunded with the forthcoming series 2017 bonds. Outstanding rated series 2015 and the upcoming series 2017 bonds are fixed rate with relatively level amortization.

DEBT-RELATED DERIVATIVES

The school has no debt-related derivatives.

PENSIONS AND OPEB

Hill does not participate in a defined benefit pension plan. The school has manageable exposure to a defined contribution plan to which it contributed \$1.2 million or a moderate 3.5% of operating expenses in fiscal 2017. The plan is available to full-time employees after one year of service or above the age of 26. The school's contribution levels vary depending on employee type and years of service. There are no retiree health care liabilities.

Governance and Management: Prudent financial management and planning

Board and senior leadership's prudent oversight and careful planning support Hill's favorable strategic and competitive positioning. Management has a proactive approach to risk management; policies and procedures are regularly reviewed and adjusted as necessary. The school has significantly grown its advancement staff in efforts to better leverage a healthy pool of prospective donors. Hill is nearing the conclusion of a five-year comprehensive strategic plan with goals of improving campus facilities, increasing student financial aid, bolstering faculty compensation, and broadening community engagement.

Legal Security

The series 2017 bonds are unsecured general obligations of the school.

Use of Proceeds

Proceeds of the proposed series 2017 bonds will refund unrated series 2002 bonds and series 2008 bank loan; as well as fund a dining hall renovation and other campus improvements.

Obligor Profile

The Hill School, founded in 1851, is a private co-educational high school in Pottstown, PA for day and boarding students. The school has an FTE enrollment of 522 students and operating revenue of \$34 million.

Methodology

The principal methodology used in this rating was US Independent Schools Methodology published in February 2013. Please see the Rating Methodologies page on www.moody.com for a copy of this methodology.

Ratings

Exhibit 2

Hill School, PA

Issue	Rating
Revenue Bonds (The Hill School Project) Series of 2017	A1
Rating Type	Underlying LT
Sale Amount	\$17,620,000
Expected Sale Date	12/14/2017
Rating Description	Revenue: 501c3 Unsecured General Obligation

Source: Moody's Investors Service

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