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Charlotte-Mecklenburg Hospital Authority (Carolinas HealthCare System), North Carolina; Joint Criteria; System

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Credit Profile		
US$163.0 mil hlth care rev rfdg bnds ser 2012A due 01/15/2043		
Long Term Rating	AA-/Stable	New
Charlotte Mecklenburg Hosp Auth		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Long Term Rating	AA-/A-2/Watch Neg	Current
Charlotte-Mecklenburg Hosp Auth		
Long Term Rating	AA-/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services has assigned its 'AA-' long-term rating to the $163 million series 2012A fixed-rate revenue and refunding bonds to be issued by the Charlotte-Mecklenburg Hospital Authority, N.C. Standard & Poor's has also affirmed its 'AA-' long-term rating and underlying ratings (SPUR) on the authority's previously issued bonds. The authority does business as Carolinas HealthCare System (CHS).

Three letters of credit (LOCs; 'AAA/A-1') from US Bank N.A. support the series 2005B, 2005C, and 2005D bonds. We based the long-term rating component on the application of joint criteria, which reflects the rating on US Bank (A+/A-1) and the 'AA-' SPUR on CHS. The short-term rating component reflects the 'A-1' short-term rating on US Bank. The LOCs supporting the series 2005B, 2005C, and 2005D bonds expire Feb. 17, 2016.

Supporting the series 2007B and 2007C bonds, which carry a dual rating of 'AA-/A-1', are standby bond purchase agreements (SBPA) from JPMorgan Chase Bank N.A. The long-term rating component reflects the 'AA-' long-term rating on CHS, and the short-term rating component reflects the 'A-1' short-term rating on JPMorgan Chase Bank. The SBPAs supporting the series 2007B and 2007C bonds expire May 4, 2015.

Assured Guaranty Municipal Corp., formerly known as Financial Security Assurance Inc. ('AA-') insures the series 2007D, 2007E, 2007F, and 2007G bonds. In addition, three Dexia Credit Local SBPAs support the 2007D, 2007E, and 2007F bonds, while a Bank of America LOC supports the series 2007G bonds. The 'A-2' short-term rating on the series 2007D, 2007E, and 2007F bonds reflects liquidity support provided by Dexia Credit Local. The SBPAs supporting the series 2007D, 2007E, and 2007F bonds expire Sept. 18, 2017.

An LOC provided by Bank of America ('A/A-1') support the series 2007G variable-rate demand bonds, which we rate 'AAA/A-1'. We based the long-term rating component on insurance from Assured Guaranty Municipal Corp ('AA-'), and the application of joint criteria between Bank of America ('A/A-1') and the 'AA-' SPUR on CHS. The short-term rating component reflects the 'A-1' short-term rating on Bank of America. The LOC expires Jan. 1, 2016.

An LOC provided by Wells Fargo Bank supports the series 2007H variable-rate demand bonds, which we rate

'AAA/A-1+'. We based the long-term rating component on the application of joint criteria reflecting the rating on Wells Fargo Bank ('AA-/A-1+') and the 'AA-' SPUR on CHS. The short-term rating component reflects the 'A-1+' short-term rating on Wells Fargo Bank. The LOC supporting the series 2007H bonds expires June 20, 2016.

The overall financial profile has improved steadily to healthy levels consistent with the 'AA-' rating, fully recovering from margin compression during 2008 and 2009. Operating results increased in 2011, surpassing 2007 levels due to continued volume and revenue growth and cost controls, particularly labor, benefits, and supplies expenses. The additional debt represented by the series 2012A issuance, will compress certain pro forma balance sheet ratios in the near term -- in particular, pro forma cash to debt will be weak -- while the organization absorbs the additional debt. In our opinion, though pro forma debt service coverage was healthy in fiscal 2011 due to the strong operating results, CHS' balance sheet has limited capacity for substantial future debt at the current rating. Management has indicated that it has no future debt plans.

Management intends to spend $1.7 billion on capital between 2012 and 2016 -- an amount that could be reduced further if management deems it necessary. Though the capital plan is large, in our opinion, management indicates that CHS is able to accommodate the annual spending due to its operating cash flow levels and because the plan's focus is on revenue-enhancing projects. In our view, the level of capital spending could limit the rate of future balance sheet accretion, particularly as the organization has added incremental debt. CHS has spent, on average, 2 times depreciation expense for the past four years, whereas management expects to spend at a rate of 1.3 times depreciation expense, which should help to grow the balance sheet from 2012 through 2016. Funding sources for the capital plan are cash from future operations (including American Recovery and Reinvestment Act funding), philanthropy, future monetization of office space, and bond proceeds from the upcoming series 2012A bonds.

In our view, additional positive rating factors include:

- Healthy pro forma debt service coverage in 2011;
- Favorable balance sheet, with days' cash on hand as of Dec. 31, 2011, that is consistent with the rating;
- Maintenance of a significant business position within the states of North and South Carolina as the largest health care provider;
- An experienced management team that has a long record with the organization; and
- Robust population growth with very strong economies in the county and Charlotte, N.C.

Partly offsetting credit factors include CHS':

- Continued exposure to underlying variable-rate debt, though the degree of the exposure has lessened in light of the 2009 debt restructuring; and
- Light pro forma cash-to-debt ratio in 2011.

The rating reflects a $54 million upfront lease payment to Union County for the amended and restated lease through 2061 of the CMC-Union facility. CHS' $2.2 billion of unrestricted liquidity on Dec. 31, 2011, and healthy operating cash flow fully offsets the upfront lease payment.

CHS' unrestricted cash equates to 305% of $732.8 million of puttable debt in the event of repurchase. However, notwithstanding favorable repayment provisions in the SBPAs and LOCs for repurchased bonds, any substantial repurchase of variable-rate debt could limit CHS' ability to spend on future capital needs, due to the comprehensive nature of the five-year plan.

Beyond the series 2012A bonds, management does not plan to issue significant additional debt within the next several years. Management will use the series 2012A bonds to refund the series 2001A bonds, as well as to refund the outstanding series 2002A and 2002B CMC-Union bonds that CHS currently guarantees, and provide $50 million for the capital plan. Management expects to use future operating cash flows to strengthen the balance sheet further. We based the pro forma debt service calculation on CHS' maximum annual debt service (MADS) of $102.2 million. CHS' pro forma debt structure will be 42% variable-rate and 58% fixed rate, with a total of $1.7 billion of pro forma long-term debt as of Dec. 31, 2011.

Upon closure of the series 2012A bonds, CMC-Union will be a part of the obligated group, which includes CHS' primary enterprise and the foundation. A gross revenue pledge of the obligated group secures all bonds, and all ratios cited within this report refer to the obligated group, unless otherwise noted.

Outlook

The stable outlook reflects our assessment of CHS' very strong business position and strengthening overall financial profile. We also expect that management will likely sustain operating profitability at or near current levels of 3% to 4% operating margins and maintain overall financial flexibility in light of the capital spending program, with debt service coverage of at least 4.5x, days' cash on hand no lower than 200, and cash-to-debt of between 130% and 150%.

We could consider a positive rating action beyond the one- to two-year outlook period if CHS absorbs the debt and capital plan successfully, with a trend of coverage sustained at greater than 5x, days' cash on hand sustained between 240 and 275 days and cash to debt sustained at greater than 200%. A negative outlook or lower rating during the next one to two years is unlikely due to the strength of the financial profile and business position. Should operating profitability or liquidity decrease to levels not commensurate with the current rating, with coverage sustained at levels less than 3.5x, or cash to debt lower than 130%, we could consider a negative outlook or rating change during the next one to two years.

Enterprise Profile

CHS' is the larger of two health care systems serving the Charlotte region and offers area residents convenient access to all primary and secondary services, in addition to a broad tertiary and quaternary service mix, including its recognized strength in key specialties such as pediatrics, cardiology, orthopedics, and neurosciences. CHS' primary enterprise consists of 10 hospitals (two tertiary and quaternary, three tertiary, and two acute-care hospitals with a total of 1,801 licensed beds, one behavioral health facility with 66 licensed beds, and two rehabilitation facilities with 169 licensed beds), two long-term care facilities with 292 licensed beds, and a large physician network of primary and specialty physicians and faculty at Carolinas Medical Center.

CHS' strategy of broadening its geographic outreach through a network of nonobligated entities, including 23 hospitals and eight related nursing homes. These entities make up the component units or managed entities. The component units, which are separately included in CHS' audit, are profitable and generate solid coverage of debt and related lease payments. CHS has its direct management expenses reimbursed and receives a network development fee of 7% to 11% of cash flow from these component units. The primary enterprise received roughly $6.8 million in network development fees last year from the component units, which are treated as a net assets

transfer and are not added back into CHS' income or debt service coverage. CHS guarantees about $1.5 million of annual operating lease payments for the component units. As these entities are all solidly self-supporting, we do not factor in the guaranteed lease payments into debt service coverage.

Utilization

Overall primary enterprise acute-care adjusted inpatient discharges increased to 211,840 in 2011 from 201,155 in 2010. The increase stems from growth at Carolinas Medical Center, programmatic growth associated with recent capital investments (such as Levine Children's Hospital), and continued growth of CHS' physician network, which has contributed to greater downstream admissions and outpatient volume. Surgery volume for the acute-care facilities increased to 70,670 in 2011 from 69,520 in 2010. Management reports that CHS volume growth during 2011 outpaced that of other providers in the service area.

Market position and physician network

CHS' inpatient market share (including all facilities owned, leased, or managed) in the service area -- consisting of the 34-county region -- remained strong at 35.8%, with the balance shared by Charlotte-based Presbyterian Hospital and its affiliates, as well as by individual community hospitals that have strong positions in their home counties. CHS has strong market share in key service lines, which we view as a credit strength. Competition comes largely from the 531-licensed bed Presbyterian Hospital and its two community hospitals, which have a market share of 40% in Mecklenburg County compared with CHS' 55% Presbyterian is part of the Novant Health System ('A+'), which includes Forsyth Memorial Hospital, based in Winston-Salem. CHS' market share has grown since the mid-1990s at the expense of Presbyterian. Managed-care accounts for approximately 40% of revenue and CHS contracts with all substantive managed-care payors in the region. CHS competitors have experienced some payor-mix erosion because CHS' Medicaid and uncompensated care inpatient market share has decreased in recent years.

Large multispecialty and single-specialty medical groups characterize the Charlotte region. CHS' physician network remains a core business strength, in our opinion, with approximately 1,200 community based and faculty physicians, generating 4.3 million visits annually. Carolinas Medical Center is one of five academic medical center teaching hospitals designated by the State of North Carolina, with approximately 266 medical residents in 12 specialties.

County relationship

Population growth in the county and the metropolitan region remains healthy, with a regional growth rate of more than 2% annually, which is projected to continue through at least the next five years. Mecklenburg County has historically funded the operating deficits of Carolinas Medical Center's outpatient indigent care clinic, as well as other indigent care provided to Mecklenburg County residents. The commitment, including to behavioral health, amounts to $37.7 million annually. However, CHS is in litigation with the county regarding the early termination of the contracts, and management expects the county payments could decrease substantially. In 2012, CHS expects to net $27 million in North Carolina Medicaid assessment monies.

Management

The management team has been in place for well more than 15 years, which we believe promotes the organization's stability. Senior management has focused on a strategy of growth, clinical quality, geographic expansion, and programmatic growth, and as a result, has produced consistent volume and revenue growth. CHS has become the market leader due to the successful execution of its strategy. Its large scale and management expertise has allowed

CHS to produce strong results across the total enterprise.

In our view, CHS' approach to debt in the past few years has moderated with modest debt issuances following a fairly aggressive 2007 issuance that doubled its long-term debt load as it brought CMC-Northeast into the organization. Though the income statement has absorbed the additional debt effectively at the current rating, the balance sheet has not yet recovered its former strength given the size of the debt load. We expect that management's growth strategy, which has been producing increasing volumes and revenue, will help strengthen the balance sheet in the next few years.

Financial Profile

Income statement

Profitability for the obligated group has improved gradually since 2008, rebounding to stronger than pre-recession levels due to volume and revenue growth, as well as continued expense controls. CHS' cost-control program is highlighted by sharply controlled labor, pharmacy, and supplies expenses that increased just marginally over the past few years, compared with a national average annual percentage increase in the low teens. Pension expense increased in 2011 due to the growth in plan participants and the ongoing actuarial smoothing of investment gains and losses incurred since 2008. We view the increasing profitability as a source of stability at the current rating, and a key factor in CHS' ability to absorb the CMC-Union and series 2012A debt. Operating income increased to $134.4 million (3.4% margin) in 2011, up from $107.6 million (3% margin) in 2010. Management expects to earn $93.3 million from operations in 2012.

Excess income also increased significantly in 2011 due to greater operating cash flow and favorable realized investment returns, to $307.8 million (7.5% margin) from $182.5 million (5% margin) in 2010. Excess (net) income excludes $179.7 million of unrealized losses in 2011 and $135.5 million of unrealized gains in 2010. Pro forma debt service coverage was healthy for the rating at 5.5x in 2011, compared with an adequate 4.1x in 2010.

Balance sheet

CHS' core strength, has historically been its balance sheet. Since 2009, favorable investment returns, sound operations, a continued low balance of accounts receivable, and improved revenue-cycle management have increased cash on an absolute basis. In addition, CHS contributed a large amount of $61.8 million to its pension plan in 2011 compared with a contribution of $53.4 million in 2010.

Unrestricted cash was flat at $2.2 billion as of Dec. 31, 2011, and Dec. 31, 2010, due to significant unrealized losses related to market volatility. Due to growth in the overall expense base, days' cash on hand decreased to 226 from 243 during the same period. Pro forma cash to debt was, in our opinion, weak for the rating at 132% as Dec. 31, 2011, due to the series 2012A bond issuance, while we considered pro forma leverage moderate for the rating at 35% as of Dec. 31, 2011.

CHS' asset allocation is fairly balanced, in our opinion, at 29% domestic equity, 20% international equity, 36% fixed income, 7% cash, and 8% alternative investments. CHS' unfunded private equity commitments as of Dec. 31, 2011, were, in our view, minimal at $21.8 million.

Swaps

In 2006, CHS entered into a floating-to-fixed rate swap on the series 2005B-D (uninsured) with Bank of America ('A') for an initial notional amount of $93.9 million. In 2007, CHS entered into several floating-to-fixed rate swaps

on the series 2007B-H bonds (insured) and series 2007L bonds (uninsured) with Wells Fargo Bank ('AA-'), Citigroup ('A'), and Bank of America for a total initial notional amount of $709.1 million. The swap on the series 2007L bonds was terminated in 2009. Current total notional amount stands at $732.8 million as of Dec. 31, 2011. Despite a significant mark to market of negative $279.5 million as of Dec. 31, 2011, CHS has not had to post any collateral related to its swap portfolio, as the collateral posting requirement for insured swaps is based on a simultaneous downgrade of both the insurers (Assured Guaranty Municipal Corp. or Ambac) to 'BBB+' and CHS to 'A'.

Charlotte Mecklenburg Hospital Authority d/b/a Carolinas HealthCare System Financial Statistics

	Carolinas HealthCare System				Medians	
	2011	2010	2009	2008	Healthcare systems AA 2010	Healthcare systems AA- 2010
Financial performance						
Net patient revenue ($000s)	3,508,898	3,230,850	3,020,790	2,757,694	2,134,735	1,732,150
Total operating revenue ($000s)	3,931,471	3,578,363	3,299,588	3,033,307	MNR	MNR
Total operating expenses ($000s)	3,797,056	3,470,785	3,224,893	2,968,373	MNR	MNR
Net nonoperating income ($000s)	173,400	74,968	(19,822)	(8,251)	MNR	MNR
Operating margin (%)	3.42	3.01	2.26	2.14	4.60	3.98
Excess margin (%)	7.50	5.00	1.67	1.87	6.20	6.63
Operating EBIDA margin (%)	9.78	9.57	9.68	9.90	MNR	MNR
EBIDA margin (%)	13.59	11.42	9.13	9.66	11.70	12.47
Net available for debt service ($000s)	557,850	417,266	299,559	292,117	MNR	MNR
Maximum annual debt service ($000s)	102,192	102,192	102,192	102,192	MNR	MNR
Maximum annual debt service coverage (x)	5.46	4.08	2.93	2.86	5.60	5.19
Operating lease-adjusted coverage (x)	N.A.	N.A.	N.A.	N.A.	4.10	4.01
Liquidity and financial flexibility						
Unrestricted cash and investments ($000s)	2,233,594	2,197,270	1,971,487	1,582,031	MNR	MNR
Unrestricted days' cash on hand	225.6	243.4	236.4	206.2	258.80	203.80
Unrestricted cash/total long-term debt (%)	138.3	148.1	131.5	103.9	213.80	156.60
Cash available within 30 days/contingent liability (%)					MNR	MNR
Average age of plant (years)	8.3	9.4	8.4	8.1	9.40	9.20
Capital expenditures/depreciation and amortization (%)	180.2	170.4	210.2	250.1	137.00	120.89
Debt and liability						
Total long-term debt ($000)	1,615,091	1,483,796	1,498,728	1,521,937	MNR	MNR
Long-term debt/capitalization (%)	33.6	32.8	37.5	42.3	29.10	32.60
Contingent liability ($000)	732,780				MNR	MNR
Contingent liability/total long-term debt (%)	45.4				MNR	MNR
Debt burden (%)	2.49	2.79	3.11	3.38	2.00	2.21
Defined benefit plan funded status (%) market Value	72.5%				82.30	64.02

Charlotte Mecklenburg Hospital Authority d/b/a Carolinas HealthCare System Financial Statistics (cont.)

Pro forma ratios	
Maximum annual debt service coverage (x)	5.46
Debt burden (%)	2.49
Unrestricted days' cash on hand	225.61
Unrestricted cash/total long-term debt (%)	132.20
Long-term debt/capitalization (%)	34.63

MNR--Median not reported. N.A.--Not available.

Related Criteria And Research

- USPF Criteria: Not-For-Profit Health Care, June 14, 2007
- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- USPF Criteria: Bank Liquidity Facilities, June 22, 2007
- USPF Criteria: Standby Bond Purchase Agreement Automatic Termination Events, April 11, 2008
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012

Ratings Detail (As Of April 23, 2012)

Charlotte Mecklenburg Hosp Auth		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Long Term Rating	AAA/A-1	Affirmed
Charlotte-Mecklenburg Hosp Auth		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Long Term Rating	AAA/A-1	Affirmed

Many issues are enhanced by bond insurance.