MOODY'S
INVESTORS SERVICE

New Issue: MOODY'S ASSIGNS Aa3 RATING TO CHARLOTTE-MECKLENBURG HOSPITAL AUTHORITY'S (NC) $163 MILLION OF SERIES 2012A BONDS; OUTLOOK IS STABLE

Global Credit Research - 18 Apr 2012

CHARLOTTE-MECKLENBURG HOSPITAL AUTHORITY HAS A TOTAL OF $1.7 BILLION OF RATED DEBT TO BE OUTSTANDING

CHARLOTTE-MECKLENBURG HOSPITAL AUTHORITY, NC
Hospitals & Health Service Providers
NC

Moody's Rating

ISSUE	RATING
Healthcare Revenue Bonds Series 2012A	Aa3

Sale Amount	$163,000,000
Expected Sale Date	05/09/12
Rating Description	Revenue: Other

Moody's Outlook STA

Opinion

NEW YORK, April 18, 2012 --Moody's Investors Service has assigned a Aa3 rating to Charlotte-Mecklenburg Hospital Authority's (d/b/a Carolinas HealthCare System) $163 million of Series 2012A fixed rate revenue bonds. The outlook is stable. At this time, we are affirming our Aa3 rating and stable outlook on $1.7 billion of debt to remain outstanding (see RATED DEBT section below).

SUMMARY RATINGS RATIONALE: The assignment of the Aa3 rating reflects CHS' strong market position in the Charlotte metro area, stable operating performance, and good balance sheet metrics. The new money portion of the current offering is a manageable 3% increase in debt outstanding, after considering the assumption of $40 million of debt in January 2012 after the debt of CMC - Union was guaranteed by the obligated group. The rating is constrained by operating performance levels and balance sheet ratios that are not consistent with a higher rating.

STRENGTHS

*Large health system with over $4.1 billion of revenue and 105,000 admissions. In addition to its community hospitals, CHS operates several sizeable facilities including a major teaching hospital and two children's hospitals

*Sizeable network of nearly 1,400 employed physicians and full spectrum of services allows CHS to retain referrals and patient volume within the System

*Three consecutive years of same store admission growth with growth of 2.0% in FY 2011 and 3.4% in FY 2010, at a time when many other providers are reporting flat or negative volume trends

*CHS maintains the highest level of tertiary and quaternary admissions in the state, providing the highest end clinical services in the region

*Long-standing and successful hospital management business provides CHS with access to new markets and a platform from which to grow the business

*Highly liquid balance sheet with only $61 million exposure to illiquid assets out of $2.2 billion of unrestricted cash and investments

CHALLENGES

*Mecklenburg County has recently terminated an indigent care and behavioral health contract worth $37.7 million annually due to its own budget pressures; the North Carolina Medicaid assessment program is expected to net CHS $27 million in FY 2012 and CHS is working on several other plans to address the loss of these contracts

*Moderate concentration in Charlotte with 35% of admissions coming from Mecklenburg County, although area unemployment trends have improved to 10.2% unemployment after growing to over 12% during the recession.

*Sizeable capital plans of $1.7 billion over the next five years (including CMC - Union capital), although current projections are for spending at a lower rate than the past five years

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: The bond proceeds will be used to 1) refinance the CHS $88.5 million Series 2001A bonds 2) refinance the CMC - Union $32.2 million bonds 3) fund future various capital expenditures, and 4) pay the costs of issuance.

LEGAL SECURITY: The bonds are secured by a revenue pledge from the members of the Obligated Group, which is comprised essentially of the "Primary Enterprise" (primarily the four acute care hospitals located in Mecklenburg County, CMC-NorthEast, a 457 licensed bed hospital located in Cabarrus County, CMC-Lincoln, a 101 bed hospital located in Lincoln County, and CMC - Union, a 157 licensed bed hospital in Union County) and one of CHS' discretely presented "Component Units", The Carolinas HealthCare Foundation (CHF). CMC - Union will become a member of the Obligated Group with this transaction.

Throughout this report, all references to CHS and financial performance are based on the primary enterprise which includes seven directly owned acute care hospitals and management contract revenue; "component unit" hospitals are excluded as their assets are controlled by the individual hospitals and do not roll up to the primary enterprise.

Ratios and statistics for FY 2010 do not include CMC - Union while those for FY 2011 do include CMC - Union, except where noted otherwise.

INTEREST RATE DERIVATIVES: CHS has entered into a total of fourteen fixed payer swaps with a total notional amount of approximately $733 million under which CHS makes fixed rate payments and receives floating rate payments based on SIFMA and LIBOR. At December 31, 2011, CHS' swap portfolio had a mark-to-market liability of $279.5 million. CHS is required to post collateral on one uninsured swap with a notional amount of $77.1 million should the fair value liability reach $25 million on the swap and CHS ratings fall below A1 from Moody's and A+ from Standard & Poor's. The remaining thirteen swaps are insured by Assured Guaranty Municipal Corp. and Ambac with no requirement for CHS to post collateral as long as the insurer is rated at least A3 by Moody's and A- by Standard & Poor's, CHS' rating remains above A2/A, and the market-to-market liability on any single swap is not greater than $25 million. CHS is not required to post any swap collateral at this time and has not had to since the swaps were put in place.

MARKET POSITION/COMPETITIVE STRATEGY: GROWING MARKET SHARE IN CHARLOTTE AND BROAD REACH THROUGHOUT THE CAROLINAS

CHS owns or operates nearly three dozen hospitals in North and South Carolina. The Primary Enterprise, which is the organization on which we base our analysis, is comprised of seven acute care hospitals with over $4.1 billion operating revenue. Effective with this transaction, CHS is adding CMC - Union, a 157 licensed bed hospital in Union County 27 miles southeast of Charlotte to the Obligated Group and the Primary Enterprise. Union is a profitable hospital with approximately $220 million revenue base, $40 million of debt, and 8,400 admissions. Given that CHS leased / managed CMC - Union for many years, this does not represent a change in strategy. Furthermore, the addition of CMC - Union to the Primary Enterprise is accretive to CHS' financial statistics. The Primary Enterprise is geographically concentrated in Charlotte and the surrounding communities. Although unemployment spiked during the recession, Charlotte is a generally good market with pockets of strong population growth. CHS manages hospitals in other North Carolina markets and various markets in South Carolina and has an ownership interest in a South Carolina hospital; revenue from these arrangements is reported as other operating revenue and are included in the Primary Enterprise financial results.

Charlotte is a competitive market and Carolinas Medical Center, the CHS flagship, competes with Novant's Presbyterian Hospital. CHS defines its core market as the Charlotte Metro area and several surrounding counties in North and South Carolina. Within this market, CHS has improved market share to 49.4% over the last five years.

Additionally, the organization has enjoyed volume growth at all Primary Enterprise hospitals over the past three years, which is notable given generally declining volume trends nationwide.

CHS operates a wide variety of facilities within Charlotte that allow it to treat virtually any patient, draw patients from outside the region, and limit outmigration. On the Carolinas Medical Center campus (the system's flagship hospital), CHS operates the Levine Children's Hospital (a hospital within a hospital and the largest children's hospital between Atlanta and Washington DC), and the Sanger Heart and Vascular Institute, a comprehensive heart hospital. CHS provides patients with a wide variety of access points in addition to the system's hospitals including hundreds of physician offices with over 1,400 employed physicians, urgent care centers, and several Healthcare Pavilions that provide a variety of outpatient services including emergency care, physician offices, and ambulatory surgery.

OPERATING PERFORMANCE: STABLE OPERATING PERFORMANCE CONTINUES

Financial performance in FY 2011 continued the organization's historical record of good performance. Exclusive of CMC - Union, inpatient admissions grew 2.0% to 97,035 and contributed to strong operating revenue growth of 9.4%. Exclusive of CMC - Union, the operating cash flow margin was flat at 10.2% and remains adequate for the rating category. The addition of CMC - Union is accretive and moderately improves financial performance and leverage metrics (see KEY INDICATORS section for additional detail).

Over the past two years, management has transferred the orthopedic and bariatric surgery programs from the flagship facility to CMC - Mercy, which has resulted in strong volume growth at Mercy and allowed CHS to backfill patient volume at Carolinas Medical Center. Management believes this type of reorganization of services among its hospitals in the Charlotte area will allow it to achieve greater efficiencies and drive market share gains.

Despite the improving economy and favorable unemployment trends in the Charlotte market, CHS does have exposure to Medicaid that is slightly above the national average at roughly 15% of gross revenue (national median is 12.5%). The higher Medicaid exposure may be driven in part by CHS's position as a governmental organization and historical provider of charity care in the Charlotte market. The Mecklenburg County government has elected to cancel an indigent care and behavioral health contract worth $37.7 million annually. Management has sued the County over what it contends is unlawful early termination of the contracts, but is also developing plans to lessen the direct financial impact of the contract terminations. Additionally, CMS recently approved the North Carolina Medicaid assessment program (a provider tax program similar to other states) which is expected to net CHS $27 million in FY 2012.

BALANCE SHEET POSITION: HIGHLY LIQUID BALANCE SHEET; ADEQUATE LIQUIDITY RATIOS

CHS maintains a large and diversified investment portfolio of over $2.2 billion (over $2.3 billion including CMC - Union funds). The portfolio is highly liquid (nearly all cash and investments are available within a month) and has a relatively conservative allocation of 7% cash, 36% fixed income, 59% equity, with the balance in private equity and alternative asset funds.

Absolute cash balances have increased in each of the last three years with only modest increases in debt. Capital spending over the next five years is substantial at approximately $1.7 billion, but is lower than recent years at 1.3 times depreciation expense. Capital spending has averaged 2.2 times depreciation expense since FY 2007, although it was below 2.0 times in FY 2010 and 2011.

The current bond issue is a modest 3% increase in debt outstanding compared to the combined CHS and CMC - Union balance sheet at December 31, 2011 and has minimal impact on key leverage metrics. Pro-forma debt-to-cash flow is 3.42 times, a level lower than recent years, and Moody's adjusted MADS coverage of 5.68 times is slightly better than the FY 2010 ratio of 5.46 times due to the accretive impact of CMC - Union.

CHS maintains a defined benefit pension plan. At FYE 2011, the plan had a $221 million unfunded liability (72.5% funded based on actual value of plan assets) with annual contributions that have increased significantly in recent years from $35 million in FY 2007 to nearly $62 million in FY 2011. In addition, CHS has approximately $50 million in annual lease expense translating into a pro-forma cash-to-comprehensive debt position of 104%, which is slightly lower than the FY 2010 Aa3 median of 113%.

Outlook

The stable outlook reflects our expectation that CHS will continue to generate favorable operating results and good debt service coverage metrics.

WHAT COULD MAKE THE RATING GO UP

Improvement in operating profitability; strengthening of balance sheet metrics; growth in market share and revenue

WHAT COULD MAKE THE RATING GO DOWN

Sustained operating losses; weakening of balance sheet metrics; additional debt without commensurate revenue growth

KEY INDICATORS

Assumptions & Adjustments:

- Based on financial statements for The Charlotte-Mecklenburg Hospital Authority (d/b/a Carolinas HealthCare System); Moody's numbers below represent the Primary Enterprise (primarily the four acute care hospitals located in Mecklenburg County, CMC-NorthEast, a 457 licensed bed hospital located in Cabarrus County, and CMC-Lincoln, a 101 bed hospital located in Lincoln County) and one of CHS' discretely presented "Component Units", The Carolinas HealthCare Foundation (CHF). The FY 2011 numbers include CMC - Union reflecting management prepared eliminations.

-First number reflects audit year ended FY 2010

-Second number reflects unaudited year ended FY 2011 plus Series 2012A bonds ($50 million new money; 3% increase in debt outstanding)

- FY 2011 numbers include CMC - Union reflecting management prepared eliminations

-Investment returns normalized at 6% unless otherwise noted

*Inpatient admissions: 95,089; 97,035 (105,415 including Union)

*Total operating revenues: $3.595 billion; $4.123 billion

*Moody's-adjusted net revenue available for debt service: $485.6 million; $573.5 million

*Total debt outstanding: $1.552 billion; $1.723 billion

*Maximum annual debt service (MADS): $89.0 million; $100.9 million

*MADS Coverage with reported investment income: 4.35 times; 4.75 times (excludes investment return at CMC - Union)

*Moody's-adjusted MADS Coverage with normalized investment income: 5.46 times; 5.68 times

*Debt-to-cash flow: 3.82 times; 3.42 times

*Days cash on hand: 242 days; 226 days

*Cash-to-debt: 142%; 136%

*Operating margin (primary enterprise): 3.0%; 3.9%

*Operating cash flow margin (primary enterprise): 10.1%; 10.4%

RATED DEBT (debt outstanding as of December 31, 2011)

-Series 2001A (fixed) ($88.5 million outstanding), rated Aa3 (to be refunded with this transaction)

-Series 2005B-D (variable rate demand bonds) ($77.1 million outstanding), rated Aa1/VMIG1 based on Letters of Credit from US Bank, expiring January February 17, 2016, and Aa3 rating of Charlotte-Mecklenburg Hospital Authority

-Series 2007A (fixed) ($195.0 million outstanding), rated Aa3

-Series 2007B (variable rate demand bonds) ($86.7 million outstanding), rated Aa3/VMIG1, (supported by SBPA from JP Morgan Chase Bank NA, expiring May 4, 2015)

-Series 2007C (variable rate demand bonds) ($87.6 million outstanding), rated Aa3/VMIG1, (supported by SBPA from JP Morgan Chase Bank NA, expiring May 4, 2015)

-Series 2007D, E, F (variable rate demand obligations) $201.4 million outstanding), rated Aa3/VMIG2 based on insurance from Assured Guaranty Municipal Corp. and a SBPA from Dexia Capital, expiring September 18, 2017, Aa3 underlying rating

-Series 2007 G, (variable rate demand obligations) ($113.8 million outstanding), rated Aa1/VMIG1 based on a Letter of Credit from Bank of America and Aa3 rating of Charlotte-Mecklenburg Hospital Authority, expiring January 1, 2016

-Series 2007H (variable rate demand obligations) ($166.1 million outstanding), rated Aa1/VMIG1 based on a Letter of Credit from Wells Fargo and Aa3 rating of Charlotte-Mecklenburg Hospital Authority, expiring June 20, 2016

-Series 2008A (fixed rate) ($308.2 million outstanding), rated Aa3

-Series 2009 (fixed rate) ($208.0 million outstanding), rated Aa3

-Series 2011A (fixed rate) ($150.0 million outstanding), rated Aa3

CMC - Union Debt (to be refunded with this transaction)

-Series 2002A Bonds (fixed rate): $19.1 million outstanding, rated Aa3

-Series 2002B Bonds (Variable rate demand bonds): $15.0 million outstanding, rated Aa1/VMIG1 (letter of credit from Wells Fargo Bank, expiring January 1, 2013, two-party pay analysis), Aa3 underlying rating

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The principal methodology used in this rating was Not-For-Profit Healthcare Rating Methodology published in March 2012. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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