STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

Research

Charlotte-Mecklenburg Hospital Authority, North Carolina; Joint Criteria; System

Primary Credit Analyst:
Charlene P Butterfield, New York (1) 212-438-2741; charlene.butterfield@standardandpoors.com

Secondary Contact:
Jennifer J Soule, Boston (1) 617-530-8313; jennifer.soule@standardandpoors.com

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Credit Profile		
Charlotte-Mecklenburg Hosp Auth		
Long Term Rating	AA-/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'AA-' long-term ratings and underlying ratings (SPURs) on the Charlotte-Mecklenburg Hospital Authority, N.C.'s existing bonds. The authority, direct and through its affiliates, does business as Carolinas HealthCare System (CHS). The outlook is stable.

Three letters of credit (LOCs) from U.S. Bank National Association 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 and the 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 July 1, 2018.

Supporting the series 2007B and 2007C bonds, which we rate 'AA-/A-1' are standby bond purchase agreements (SBPA) from JPMorgan Chase Bank N.A. The long-term rating component reflects the long-term rating on the authority, 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, 2017.

An LOC from TD Bank supports the 2007E bonds, which we rate 'AAA/A-1+'. We based the long-term rating component on insurance from Assured Guaranty Municipal Corp. and the application of joint criteria between TD Bank and the SPUR on CHS. The short-term rating component reflects the 'A-1+' short-term rating on TD Bank. The LOC expires on May 30, 2018.

An LOC provided by Wells Fargo Bank supports the series 2007H variable-rate demand bonds, which we rated 'AAA/A-1+'. We based the long-term rating component on the application of joint criteria reflecting the rating on Wells Fargo Bank and the 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 18, 2019.

In 2013, the series 2007D, 2007F, and 2007G bonds were restructured from variable-rate demand bonds supported by LOCs or SBPA to variable-rate direct purchase agreements with SunTrust Bank, PNC Bank, and Bank of America, respectively, following a mandatory tender and mode change. Upon the mode change into direct purchase agreements, Standard & Poor's no longer rates the series 2007D, 2007F, and 2007G bonds, but factors the new structure into its analysis.

After significant weakening in 2013 and through the first quarter of fiscal 2014 ended March 31, management accelerated its remediation efforts intended to restore system profitability and operating cash flow. Management's initiatives were successful, producing a solid margin and debt service coverage for full fiscal 2014, consistent with 'AA-' medians. The overall balance sheet remained healthy for the rating, driven by strong operating cash flow and solid investment returns. CHS' strong enterprise profile, highlighted by increasing market share and considerable geographic reach, continue to support the rating. We expect the enterprise profile to remain strong, and anticipate continued solid operating results and balance sheet growth during the next year or two.

Management intends to spend $1.3 billion on capital projects between 2015 and 2019. CHS spent 1.4x depreciation expense in 2014, down from a previous average of 1.8x between 2011-2013, which also helped balance sheet growth. Management indicates that CHS is able to accommodate the annual spending at 1.4x depreciation expense because the plan's focus is on revenue-enhancing projects.

In our view, additional positive rating factors include:

- Favorable balance sheet, with 263 days' cash on hand as of Dec. 31, 2014, that is healthy for the rating;
- Maintenance of a significant business position within North and South Carolina as the largest health care provider;
- Robust population growth, with very strong economies in the county and Charlotte; and
- An experienced management team that has a long record with the organization.

Partly offsetting credit factors include:

- Continued exposure to underlying variable-rate debt and contingent liabilities, though the degree of the exposure has lessened in light of the 2009 restructuring; and
- Adequate excess margin in fiscal 2014.

CHS's unrestricted reserves of $3.2 billion as of Dec. 31, 2014, equate to 451% of contingent liabilities, which include puttable debt, in the event of repurchase. However, notwithstanding favorable repayment provisions in the SBPAs and LOCs for the variable-rate bonds, and adequate cure periods in the direct purchase obligations, any substantial repurchase of variable-rate or direct-purchase debt could limit CHS' ability to spend on future capital needs, and limit the rate of further balance sheet accretion.

A gross revenue pledge of the obligated group secures all bonds, which includes CHS' primary enterprise and two component units, the Carolinas HealthCare Foundation and Stanly Health Services Inc.; Stanly Health Services joined the obligated group in January 2015. All ratios cited in this report refer to the obligated group, unless otherwise noted. Our rating reflects our view of the authority's group credit profile and the obligated group's core status. Accordingly, the rating is at the level of the group credit profile.

Outlook

The stable outlook reflects our assessment of management's successful restoration of profitability in 2014, and our expectation that solid margins will continue during the next one to two years, consistent with relevant medians. In addition, the stable outlook reflects our opinion of CHS's healthy balance sheet metrics and our expectation that the balance sheet will strengthen further during the next one to two years.

We could revise the outlook to positive beyond the two-year outlook period if CHS sustains financial metrics at a level commensurate with a higher rating. Given the recent improvement in the financial profile, we do not expect to lower the rating in the next one to two years, but we could revise the outlook to negative if the operating margin decreases to a negative level or if balance sheet metrics decline sharply.

Enterprise Profile

Organization

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, cancer, and neurosciences. Currently, CHS' primary enterprise consists of 3,183 beds including the following: 10 acute-care hospitals (one tertiary and quaternary, three tertiary, and six acute-care hospitals with a total of 2,390 licensed beds); two behavioral health facilities with 132 licensed beds; four rehabilitation facilities with 179 licensed beds; four long-term care facilities with 482 licensed beds; and a large physician network of primary and specialty physicians and faculty at Carolinas Medical Center as well as home health, hospice and palliative care services.

CHS' strategy is to broaden its geographic outreach through a network of nonobligated entities, including 22 hospitals and eight related nursing homes. These entities make up the component units and managed entities. The component units are separately included in the CHS audit while managed entities are not included in the CHS audit. CHS has its direct management expenses reimbursed and also receives management fees from all managed entities, which are included in other revenue.

Utilization

Overall combined group acute-care inpatient admissions increased to 119,694 in 2014 from 115,956 in 2013. The increase stems from growth at Carolinas Medical Center, continued expansion of CHS' physician network through recruitment, and programmatic growth associated with recent strategic investments, all of which have contributed to greater downstream admissions and outpatient volume and market share growth. Surgery volume for the acute-care facilities increased to 86,899 in 2014 from 85,726 in 2013. Management reports that volume growth has continued into 2015 through April.

Market position and physician network

CHS' inpatient market share (including all facilities owned or managed) in the service area—consisting of the 34-county region—remained strong at 36%, with the balance shared by Winston-Salem based Novant Health, which includes Forsyth Memorial Hospital, 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 an institutional strength. CHS has a 50% market share in its 13-county core market, where competition comes largely from the 531-licensed bed Novant Health Presbyterian Medical Center and its affiliates. CHS' market share has grown since the mid-1990s at the expense of providers in the primary service area. Managed care accounts for about 58% of net revenue. CHS contracts with all substantive managed-care payors in the region and has several value-based shared saving arrangements. CHS competitors have experienced some inpatient payor-mix erosion because CHS' Medicaid and uncompensated care 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 1,406 community-based and faculty physicians, generating roughly 5.1 million visits annually. Carolinas Medical Center is one of five academic medical center teaching hospitals designated by North Carolina, with 295 medical residents in 33 programs.

Population growth in the county and metropolitan region remains healthy, with a regional growth rate of more than 2% annually, which management projects to continue through at least the next five years.

Management

The average tenure of the current management team is 20 years, which we believe promotes the organization's stability. Senior management has focused on a strategy of growth, clinical safety and quality, geographic expansion, and programmatic growth, which produced consistent volume and revenue growth through 2012. After a temporary slowdown in volume and revenue growth in 2013 and through the 2014 first quarter, management accelerated its clinical transformation across the system to reduce waste, enhance revenue, and restore cash flow levels. The remediation efforts, along with healthy volume growth restored operating profitability to historically solid levels for fiscal 2014.

In our view, CHS' approach to debt 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 taken a longer time to regain its former strength due to the size of the debt load and investment market turmoil during the economic recession. We expect that the recent transformation efforts and growth strategies will continue to strengthen the balance sheet during the next few years.

Financial Profile

Income statement

Operating profitability rebounded strongly to a $157.7 million gain (a 3.2% margin) in 2014 following a $7.6 million first-quarter loss, compared with $80.5 million gain (a 1.8% margin) in 2013. In our view, the short nature of the turnaround, coupled with the solid margin for 2014 support the rating and indicate effective management practices. Management reports that the rebound in profitability resulted from effective cost controls, volume and revenue growth, and greater clinical and operating efficiencies. We expect that 2015 results will be comparable with those of 2014.

Upon solid operating cash flow and favorable realized investment income, excess income increased to $295.8 million (a 5.9% margin) in 2014, from $191.1 million (a 4.1% margin) in 2013. Excess income excludes $11.3 million of unrealized losses in 2014, and $147.9 million of unrealized gains in 2013. Debt service coverage was consistent with the rating at 5.4x in 2014, compared with a light 4.5x in 2013. When adjusted for operating leases, coverage decreased to 3.9x in 2014 and 3.4x in 2013. The debt burden was light at 2.3% of operating revenue in 2014. We expect that coverage will remain at or near current levels should operating cash flow remain healthy.

Balance sheet

CHS' core strength has been its balance sheet. From 2009 through 2014, 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, $79.1 million, to its pension plan in 2014, compared with $88.5 million in 2013.

Unrestricted reserves increased to a strong $3.2 billion (263 days' cash on hand) as of Dec. 31, 2014, compared with $3 billion (258 days' cash) on Dec. 31, 2013, due to favorable investment returns and operating cash flow. Cash-to-debt was consistent with the rating, and much improved from the previous year at 173% as of Dec. 31, 2014; leverage was also in line with the rating at 32% on Dec. 31, 2014.

CHS' asset allocation is fairly balanced, in our opinion, at 28% domestic equity, 27% international equity, 27% fixed income, 8% cash, and 11% alternative investments. CHS' unfunded private equity commitments as of Dec. 31, 2014 were, in our view, minimal at $55.4 million.

Contingent liabilities

In May 2013, CHS entered into three direct purchase agreements with SunTrust Bank, PNC Bank, and Banc of America Public Capital Group, respectively, in an initial aggregate amount of $238.0 million to restructure the series 2007D, 2007F, and 2007G bonds by changing the mode from SBPA- and LOC-supported to variable rate with a seven-year term for the series 2007G bonds and 10-year terms for the 2007D and 2007F bond series. Under the terms of the agreement, each bank will hold the bonds for either seven or 10 years, at which time, unless extended, CHS may remarket the bonds, or if they cannot be remarketed, CHS may repurchase some or all of the bonds. Covenants for the CHS direct purchase agreements include the obligated group's maintenance of 1.1x DSC, at least 75 days' cash on hand, and less than 65% leverage, although not all agreements contain each covenant. An event of default could occur, if not waived by the banks, should CHS breach any of the aforementioned covenants following a 30-day cure period. In the event of default, the banks have the right to accelerate the bonds, at which time CHS would have 180 days to repurchase some or all of the bonds from the bank, or to remarket the bonds. In our view, CHS' 4.5x unrestricted reserves compared with contingent liability debt as of Dec. 31, 2014, mitigates the risk of acceleration.

In 2006, CHS entered into a floating to fixed-rate swap on the series 2005B-D (uninsured) with Bank of America for an initial notional amount of $93.9 million. In 2007, CHS entered into several floating to fixed-rate swaps on series 2007B-H bonds (insured) and series 2007L bonds (uninsured) with Wells Fargo Bank, Citigroup, 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. The current total notional amount was $718 million as of Dec. 31, 2014. Despite a significant mark-to-market of negative $252 million as of Dec. 31, 2014, CHS has not had to post any collateral related to its swap portfolio, because the collateral posting requirement for insured swaps is based on a simultaneous downgrade of both the insurer (Assured Guaranty Municipal Corporation) to 'BBB+' and CHS to 'A'.

Charlotte Mecklenburg Hospital Authority (d/b/a Carolinas HealthCare System) Financial Statistics					
	--Fiscal year ended Dec. 31--			Medians for 'AA-' rated health care systems	Medians for 'AA' rated health care systems
	2014	2013	2012	2013	2013
Financial performance					
Net patient revenue ($000s)	4,491,997	4,174,175	3,732,730	1,803,183	2,249,363
Total operating revenue ($000s)	4,905,987	4,558,827	4,167,610	MNR	MNR
Total operating expenses ($000s)	4,748,238	4,478,345	4,031,787	MNR	MNR
Operating income ($000s)	157,749	80,482	135,823	MNR	MNR
Operating margin (%)	3.22	1.77	3.26	3.00	4.90
Net non-operating income ($000s)	138,017	110,587	108,742	MNR	MNR
Excess income ($000s)	295,766	191,069	244,565	MNR	MNR
Excess margin (%)	5.86	4.09	5.72	7.20	9.00
Operating EBIDA margin (%)	10.09	8.85	10.18	10.00	10.60
EBIDA margin (%)	12.55	11.01	12.46	13.10	14.80
Net available for debt service ($000s)	633,074	514,048	532,976	343,218	436,386
Maximum annual debt service ($000s)	117,220	114,047	114,047	MNR	MNR
Maximum annual debt service coverage (x)	5.40	4.51	4.67	5.00	7.20
Operating lease-adjusted coverage (x)	3.94	3.37	3.51	3.70	5.00
Liquidity and financial flexibility					
Unrestricted reserves ($000s)	3,238,268	2,997,606	2,561,580	1,400,698	2,188,710
Unrestricted days' cash on hand	262.9	257.9	244.5	252.00	311.60
Unrestricted reserves/long-term debt (%)	172.7	158.2	152.1	168.00	240.70
Unrestricted reserves/contingent liabilities (%)	451.2	414.6	351.9	MNR	MNR
Average age of plant (years)	7.6	7.3	6.9	10.30	10.10
Capital expenditures/depreciation and amortization (%)	143.1	183.6	183.6	154.60	156.20
Debt and liabilities					
Long-term debt ($000s)	1,875,383	1,895,089	1,684,394	MNR	MNR
Long-term debt/capitalization (%)	31.6	33.4	33.4	31.20	25.80
Contingent liabilities ($000s)	717,780	722,970	727,990	MNR	MNR
Contingent liabilities/long-term debt (%)	38.3	38.1	43.2	MNR	MNR
Debt burden (%)	2.32	2.44	2.66	2.40	2.00
Defined-benefit plan funded status (%)	69.60	71.10	71.54	84.10	86.90

N.A.--not available. N/A--not applicable.

Related Criteria And Research

Related Criteria

- USPF Criteria: Contingent Liquidity Risks, March 5, 2012
- USPF Criteria: Not-For-Profit Health Care, June 14, 2007

- USPF Criteria: Municipal Applications For Joint Support Criteria, June 25, 2007
- Criteria: Joint Support Criteria Update, April 22, 2009
- General Criteria: Methodology: Industry Risk, Nov. 20, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013

Related Research

- Glossary: Not-For-Profit Health Care Ratios, Oct. 26, 2011
- The Outlook For U.S. Not-For-Profit Health Care Providers Is Negative From Increasing Pressures, Dec. 10, 2013
- U.S. Not-For-Profit Health Care System Ratios: Operating Performance Weakened In 2013, Aug. 13, 2014
- Health Care Providers And Insurers Pursue Value Initiatives Despite Reform Uncertainties, May 9, 2013
- Standard & Poor's Assigns Industry Risk Assessments To 38 Nonfinancial Corporate Industries, Nov. 20, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

Ratings Detail (As Of June 8, 2015)		
Charlotte-Mecklenburg Hospital Authority (AGM)		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Charlotte-Mecklenburg Hosp Auth hosp ARs rev bnds ser 2007E		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Charlotte Mecklenburg Hosp Auth		
Unenhanced Rating	AA-(SPUR)/Stable	Affirmed
Long Term Rating	AAA/A-1+	Affirmed
Charlotte Mecklenburg Hosp Auth Series 2007C		
Long Term Rating	AA-/A-1/Stable	Affirmed
Charlotte Mecklenburg Hosp Auth Series 2007H		
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
Charlotte-Mecklenburg Hosp Auth Series 2007B		
Long Term Rating	AA-/A-1/Stable	Affirmed

Many issues are enhanced by bond insurance.