MOODY'S
INVESTORS SERVICE

New Issue: Moody's assigns P-1 rating to Charlotte-Mecklenburg Hospital Authority's (NC) $200 million of authorized commercial paper

Global Credit Research - 01 Oct 2015

Aa3 and Aa3/VMIG 1 affirmed; approximately $1.9B rated debt

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

Moody's Rating

ISSUE	RATING
Taxable Health Care Commercial Paper Revenue Bonds Series 2015B	P-1
Sale Amount	$200,000,000
Expected Sale Date	10/14/15
Rating Description	Revenue: Government Enterprise

Moody's Outlook STA

NEW YORK, October 01, 2015 --Moody's Investors Service assigns a P-1 rating to Charlotte-Mecklenburg Hospital Authority's (d/b/a Carolinas HealthCare System) proposed taxable commercial paper bonds which will be authorized in the amount of $200 million. CHS plans to issue $25 million in CP initially. At this time we are also affirming our Aa3 and Aa3/VMIG 1 ratings on CHS' outstanding debt. The outlook remains stable.

SUMMARY RATING RATIONALE

The P-1 rating is based on CHS' Aa3 long-term rating and the adequacy of CHS' internal liquidity and treasury management to meet commercial paper maturities.

The Aa3 rating is attributable to multiple factors, including CHS' large size and geographic footprint across the Carolinas, long track-record of stable and adequate financial performance including a rebound in FY 2014 following a softer 2013, and stable balance sheet metrics. Balancing these factors are the competitive service area in Charlotte and above average Medicaid exposure. The Aa3/VMIG 1 ratings on the Series 2007B and 2007C bonds are based on standby bond purchase agreements supporting those bonds.

OUTLOOK

The stable outlook reflects our expectation that CHS will continue to generate financial results at current levels allowing it to fund IT and other necessary strategic investments while maintaining stable leverage metrics.

WHAT COULD MAKE THE RATING GO UP

- Stronger cash flow margins sustained for multi-year period

- Growth in absolute and relative liquidity metrics

- Maintenance of recent market share gains

WHAT COULD MAKE THE RATING GO DOWN

- Prolonged period of lower cash flow margins

- Significant increase in debt, or capital spending plans that require significant use of debt or balance sheet reserves

STRENGTHS

- Well articulated process for managing commercial paper maturities and liquidating funds to meet maturities, if necessary.

- CHS is a large health system with revenue diversity across several sizeable hospitals, including a children's hospital (Levine Children's Hospital), and an academic medical center, generating nearly $5.0 billion of revenue and 120,000 admissions in FY 2014

- CHS continues to gain market share in Charlotte metro region, it's largest market

- The free standing emergency department strategy continues to provide access to new markets; in addition, CHS has over 1,400 employed physicians including a large network of primary care physicians

- CHS has a relatively built out IT system and although annual spend on IT continues to consume a large share of the capital budget, the organization does not need to pursue a major IT conversion to achieve CMS meaningful use measures

- Growth with other hospitals continues; CHS recently created a new affiliation model for clinical and other services that may appeal to more hospitals seeking to maintain a greater degree of local control

- Early success with dual branded narrow network insurance product with Coventry

- Demonstrated internal controls for tracking high risk patients and responding to high risk situations as demonstrated by CHS' response to the super-bug

- Highly liquid balance sheet with approximately 90% of cash and investments liquid within a month, although exposure to alternatives has been growing

CHALLENGES

- Despite its presence in many markets throughout the Carolinas, CHS is concentrated in Charlotte metro area, limiting cash flow diversity by geography

- Market share gains in Charlotte metro area, while positive over the last several years, may be difficult to maintain going forward given the presence of a large and active competitor

- CHS has a large amount of underlying variable rate debt

- North Carolina does not currently have plans to expand Medicaid eligibility, which would likely benefit CHS given its high bad debt and charity care load

RECENT DEVELOPMENTS

During 2014, CHS became the sole member of Stanly Health Services, Inc. in Albermarle, NC. CHS previously managed Stanly. In January 2015, CHS refinanced Stanly's debt (approximately $16 million). Stanly generates approximately $130 million in revenue and is immaterial to CHS' financial position.

DETAILED RATING RATIONALE

P-1 RATING BASED ON CAROLINAS HEALTHCARE SYSTEM'S ADEQUATE INTERNAL LIQUIDITY AND TREASURY MANAGEMENT TO SUPPORT COMMERCIAL PAPER MATURITIES

The commercial paper program is CHS' first debt issuance that will be supported by internal liquidity. The program is authorized for $200 million with maturities limited to $50 million over a five day period. CHS plans to issue $25 million initially.

Commercial paper maturities will be paid for by the system's internal liquidity, in the event that they are not rolled into a new maturity, therefore Moody's applies a self-liquidity methodology to evaluating the adequacy of liquidity to meet this potential obligation. As of June 30, 2015, the system had $420 million in discounted daily liquidity, providing a very strong 8.4x coverage of $50 million in commercial paper; after excluding the largest money market fund, coverage is still adequate at 2.7x. The system's daily assets are comprised of two money market funds, which is fairly concentrated compared to other self-liquidity programs, although each fund provides

sufficient coverage on its own.

MARKET POSITION: GROWING MARKET SHARE IN CHARLOTTE; DIVERSITY OF SITES THROUGHOUT REGION

CHS' large size and revenue diversity among hospitals, physician offices, ambulatory sites, and other services are key credit strengths. Although revenue diversity is good among facilities, the organization is concentrated in the Charlotte metro area, limiting geographic diversity relative to other large healthcare systems.

CHS has long pursued a strategy to provide various access points throughout the Charlotte region. The organization employs approximately 1,400 physicians with numerous primary care and specialty offices, and has a number of free standing emergency departments. The free standing ED's (branded as "Healthplexes") are relatively quick and less expensive to build than a full service hospital, allowing CHS to enter growth areas quickly; CHS opened two new Healthplexes over the past year.

Over the last several years, CHS has translated growth in sites and practitioners and targeted growth in various service lines into market share gains in the Charlotte metro area. Per management supplied data, market share reached 50.4% in 2014, up from 48.2% in 2010. The major local competitor is Novant Health (A1 stable), and despite CHS' recent gains, we do not expect the competitive dynamic or roughly 50/50 market share to materially change.

Another smaller contributor to growth is a new insurance product; in 2014, CHS began participating in a narrow network insurance product with Coventry. The product is available on the individual and small group markets. We note that the narrow network market is competitive with other plans offering similar products, and competition from other payment models, including bundled payments, could alter market share.

In an update to its long standing management services strategy, CHS began offering a new type of affiliation service this past year called a strategic service agreement. In contrast to a management service agreement, under a strategic service agreement, CHS does not employ the local management, allowing the partnering organization to maintain a greater degree of autonomy, while continuing to access selective benefits of CHS' scale and experience as well as clinical arrangements. The service has the potential to increase the pool of organizations open to service agreements with CHS.

OPERATING PERFORMANCE, BALANCE SHEET, AND CAPITAL PLANS: RETURN TO STRONGER PERFORMANCE IN 2014 MAINTAINED IN 2015

Operating performance significantly improved in FY 2014, returning to historical levels of operating cash flow margin following a softer year in 2013. Stronger performance was attributable to better staffing models allowing the organization to better flex to demand and a modest reduction in overall FTE's. Other ongoing initiatives that contributed to stronger results include care redesign models to increase throughput and improve physician productivity. Performance remains strong through six months 2015 with an operating cash flow margin of nearly 13%.

Liquidity

Liquidity is good with 263 days cash at FYE 2014, an amount that has grown somewhat over the last few years and been consistently above 200 days for many years. Liquidity has grown modestly through six months 2015 to nearly 270 days cash on hand.

The investment strategy has not changed significantly in recent years. The investment portfolio is approximately 86% liquid on a monthly basis and the asset allocation, which includes 53% equities, 22% fixed income, and 8% in various alternatives, is typical for an organization of this size.

DEBT STRUCTURE AND LEGAL COVENANTS

Debt outstanding declined modestly in 2014 due to principal amortization. CHS does not currently have new money debt plans. Debt to revenue improved to 38% in FY 2014, from 41% the prior year. All leverage metrics exhibited improvement over the prior year.

Debt Structure

Debt structure is 38% variable before swaps including approximately 13% in direct placements with three different banks, and the balance is fixed rate. CHS has liquidity facilities with four different banks supporting tender features

on its variable rate debt. The organization actively manages and staggers renewal dates with the next renewal dates in May 2017.

Debt-Related Derivatives

CHS has fourteen fixed payer swaps under six swap agreements with a total notional amount of approximately $714 million at 6/30/15 under which CHS makes fixed rate payments and receives floating rate payments based on SIFMA and LIBOR. At December 31, 2014, CHS's swap portfolio had a mark-to-market liability of $252 million. Collateral posting thresholds vary from $25 million - $50 million and are measured against each swap agreement, not the entire portfolio. No collateral posting is required unless CHS's rating is A2/A or lower, and a portion of the swaps have a further condition, only requiring collateral posting if the insurer's rating also falls below Baa1/BBB+. CHS is not required to post any swap collateral at this time and has not had to since the swap agreements were put in place.

Pensions and OPEB

CHS maintains a defined benefit pension plan. Using GASB accounting, the plan was 70% funded. If the plan were accounted for using FASB standards and a lower discount rate, the unfunded liability would be much higher. Contributions have ranged from $70 million to $88 million over the last three years and CHS has consistently contributed 100% of the required annual pension cost to the plan.

GOVERNANCE AND MANAGEMENT

During 2015, CHS' president and chief operating officer left as part of a management restructuring. The rest of the senior management team has been in place and worked together for many years.

KEY STATISTICS

Based on financial statements for The Charlotte-Mecklenburg Hospital Authority (d/b/a Carolinas HealthCare System); Moody's numbers below represent the Primary Enterprise and the assets of The Carolinas HealthCare Foundation

First number reflects audit year ended December 31, 2013

Second number reflects audit year ended December 31, 2014

Investment returns normalized at 6% unless otherwise noted

Comprehensive debt includes direct debt, operating leases, and pension obligation, if applicable

Monthly liquidity to demand debt ratio is not included if demand debt is de minimis

- Inpatient admissions: 115,956; 119,694

- Observation stays: 44,294; 45,423

- Medicare % of gross revenues: 37.0%; 37.7%

- Medicaid % of gross revenues: 16.3%; 16.2%

- Total operating revenues ($): $4.589 billion; $4.929 billion

- Revenue growth rate (%) (3 yr CAGR): 10.9%; 10.3%

- Operating margin (%): 2.5%; 3.8%

- Operating cash flow margin (%): 9.6%; 10.6%

- Debt to cash flow (x): 3.5x; 3.0x

- Days cash on hand: 258 days; 263 days

- Maximum annual debt service (MADS) ($): $114.8 million; $117.2 million

- MADS coverage with reported investment income (x): 4.2x; 4.8x

- Moody's-adjusted MADS Coverage with normalized investment income (x): 5.4x; 6.1x

- Direct debt ($): $1.9 billion; $1.9 billion

- Cash to direct debt (%): 158%; 172%

- Comprehensive debt: $2.5 billion; $2.6 billion

- Cash to comprehensive debt (%): 118%; 125%

- Monthly liquidity to demand debt (%):363%; 389%

OBLIGOR PROFILE

CHS is headquartered in Charlotte, NC and owns or manages 39 hospitals throughout the Carolinas and Georgia. System hospitals include small community hospitals, large tertiary facilities, a children's hospital and a cancer hospital. The system also employs over 1,400 physicians.

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, located in Cabarrus County, CHS Lincoln, located in Lincoln County, CHS Union, located in Union County, CHS Cleveland and CHS Kings Mountain, both located in Cleveland County) and one of CHS's discretely presented "Component Units", The Carolinas HealthCare Foundation (CHF). Stanly joined the Obligated Group in January 2015.

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

USE OF PROCEEDS

Not applicable.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Not-For-Profit Healthcare Rating Methodology published in March 2012. The additional methodologies used in the short term rating were the Rating Methodology for Municipal Bonds and Commercial Paper Supported by a Borrower's Self Liquidity, published in January 2012, and Variable Rate Instruments Supported by Conditional Liquidity Facilities, published in March 2015. Please see the Credit Policy page on www.moodys.com for a copy of these methodologies.

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