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FitchRatings

National Association of Health and Educational Facilities Finance Authorities

Top Credit Risks Facing Hospitals and Universities

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Agenda

Fitch Ratings' Healthcare Portfolio

Fitch Ratings' Rating Process

Top Credit Risks facing Not-for-Profit
Hospitals

Fitch Ratings' Higher Education Portfolio

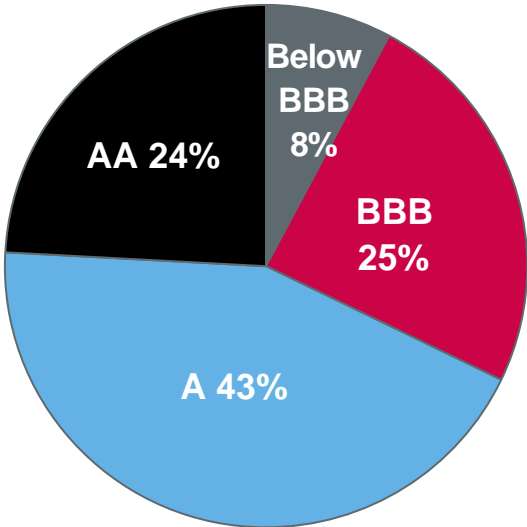
Top Credit Risks facing Higher Education
Institutions

Contact Information

Fitch Public Finance Health Care Portfolio

- 10 public finance health care analysts
 - Healthcare offices: New York (4); Chicago (4); San Francisco (2)
- 376 healthcare credits; 294 acute care, 81 senior living, and 1 physician group

Acute Care Rating Distribution by Category



Financial Performance

Nonprofit Hospital and Healthcare System Median Ratios

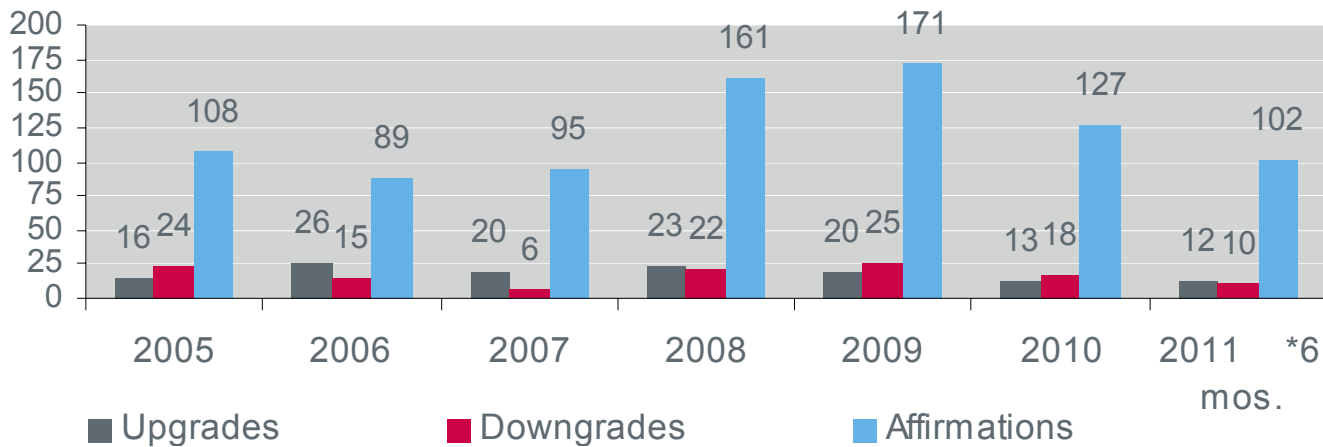
	2008	2009	2010
Sample Size	227	244	248
Days Cash on Hand	151.3	166.8	180.5
Cash to Debt (%)	101.3	104.8	112.8
Operating Margin (%)	2.2	2.8	2.6
Operating EBITDA Margin (%)	8.9	9.5	9.4
Operating EBITDA Debt Service Coverage (x)	2.8	3.0	3.0
MADS as % of Revenues	3.1	3.1	3.0
Capital Expenditures as % of Depreciation Expense	154.4	127.1	115.7

Fitch Public Finance Healthcare Portfolio

2011 Outlook: STABLE

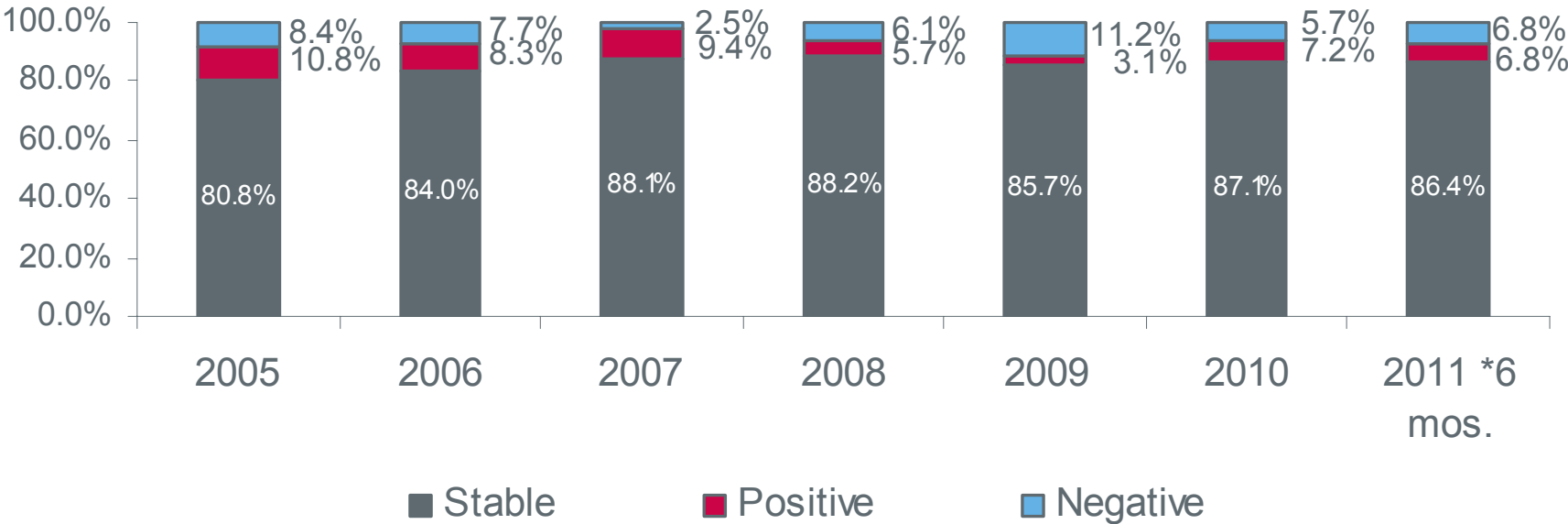
Predicated upon Fitch Ratings' expectation that the preponderance of rating activity within its universe of rated credits will take the form of affirmations, with individual credit outlooks remaining largely stable across the portfolio over the next 12 months.

Rating Actions



Fitch Public Finance Healthcare Portfolio

Credit Outlooks



Fitch Rating Process

- A credit rating is a measure of timely and sufficient payment of scheduled debt service by the obliged entity
- Rating Steps
 - Gather information/meet with management/site visit
 - Information put into a credit committee package and presented to a committee
 - Committee decision based on majority vote
 - A rating action commentary with key rating drivers and Fitch Ratings' analysis released by the end of the next business day

Criteria for Hospital Credit Analysis

- **New Issue Details:** use of proceeds, structure of debt, security, and disclosure
- **Organization:** hospital type and number of sites; system components such as insurance plan, physician group practices (employed physicians), ambulatory surgery centers, etc.
- **Governance/Management:** Board of Directors – mission/strategic focus, composition, accountability. Executive Management – backgrounds, strategic plan, initiatives and goals, structure, and succession planning
- **Medical Staff:** number of active staff, avg. age, percent board certified, top admitters, large physician group practices and joint ventures

Criteria for Hospital Credit Analysis, cont.

- **Service Area/Competition:** patient origin; demographic and socioeconomic factors such as population, unemployment, and top employers; types of competitors; market share analysis in both primary and secondary markets, and by service line
- **Utilization:** discharges/admissions, observation cases, newborn births, outpatient and emergency room visits, average length of stay, and Medicare CMI
- **Reimbursement:** Payor mix of total revenues by governmental payors (Medicare & Medicaid), managed care, self-pay, and other. Also look at charity care and bad debt, as well as the current status of managed care/commercial insurance contracts
- **Financial Performance:** Liquidity – investment allocation and the liquidity of unrestricted cash; cash and liquid investments relative to remarketed and/or puttable debt. Other measures of performance include profitability, debt burden, capital spending, and future capital needs

Top 5 Credit Risks

Facing Non Profit Hospitals and Health Systems

1. Impact of Healthcare Reform

- Healthcare landscape and environment is changing
- Efficiency Measures
 - Accountable Care Organizations (ACOs)
 - Focus on Population Health
 - Closely coordinated medical care
 - Expectation for higher quality and lower cost
- Ability to break-even on Medicare
- Physician alignment
- Consolidation/ M&A activity

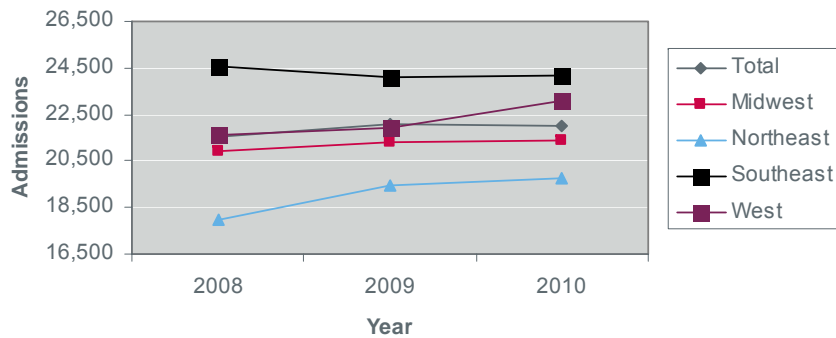
2. Economic Recovery

- Slower than expected
- Impact on volume
- Impact on Payor Mix with regard to bad debt and charity care
 - Bad debt expense is heavily influenced by general economic conditions and corporate profits
- Property tax denials and the state's quest for more revenue
- Pressure on wages and labor when recovery does in fact happen
 - Salaries, wages and benefits are the largest portion of providers overall expense base

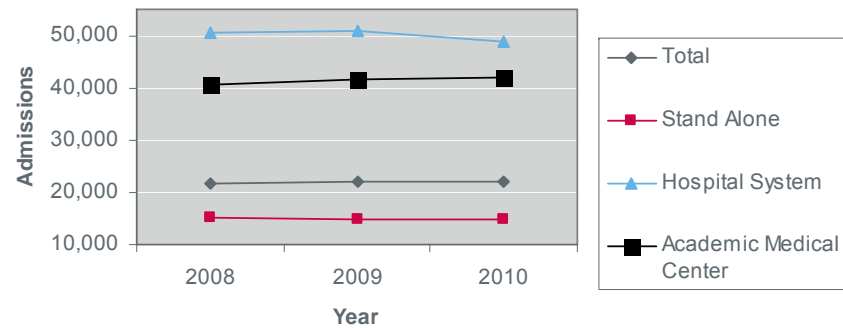
2. Economic Recovery

Impact on Volume – Admissions

Admissions by Region



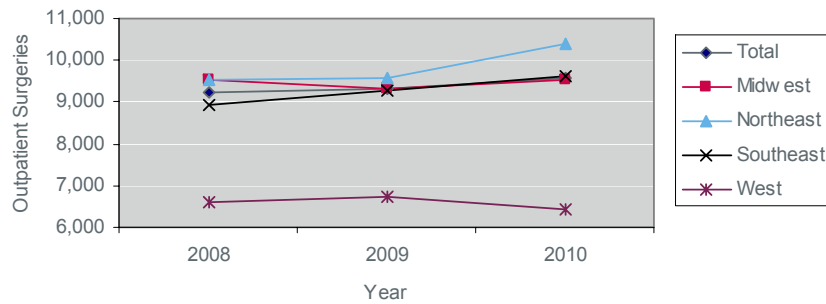
Admissions by Type



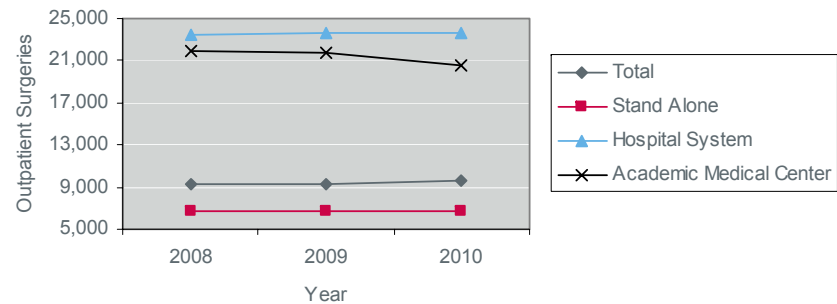
2. Economic Recovery

Impact on Volume – Outpatient Surgeries

Outpatient Surgeries by Region



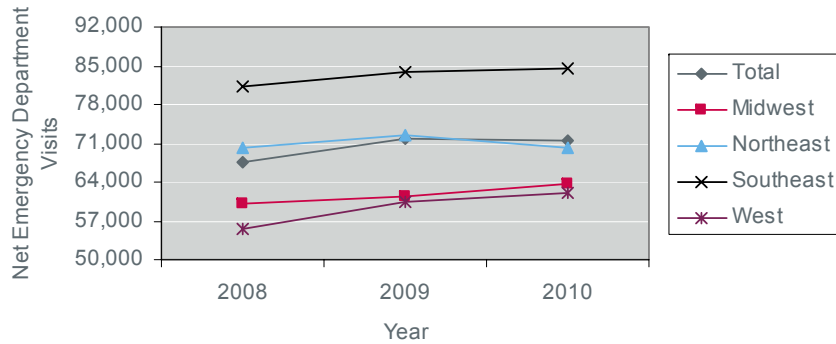
Outpatient Surgeries by Type



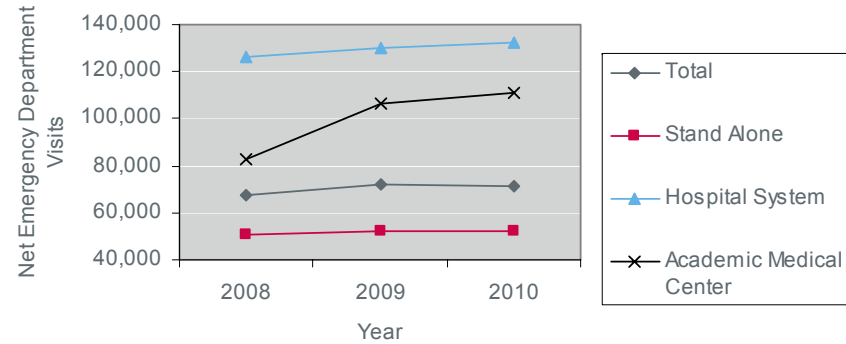
2. Economic Recovery

Impact on Volume – Net Emergency Department Visits

Net Emergency Department Visits by Region

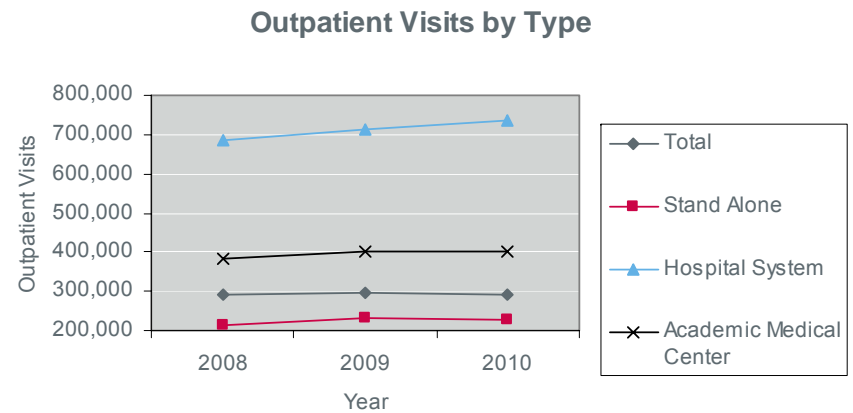
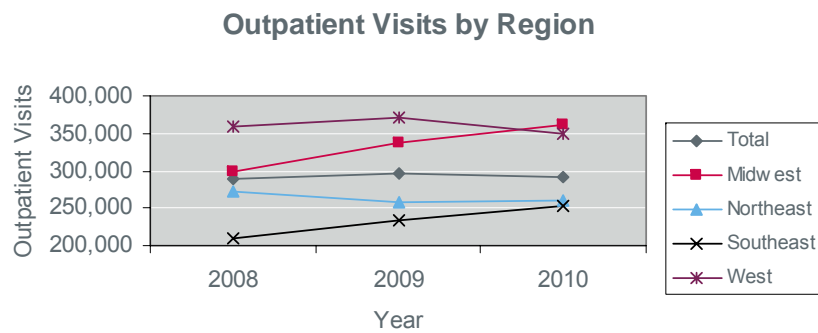


Net Emergency Department Visits by Type



2. Economic Recovery

Impact on Volume – Outpatient Visits



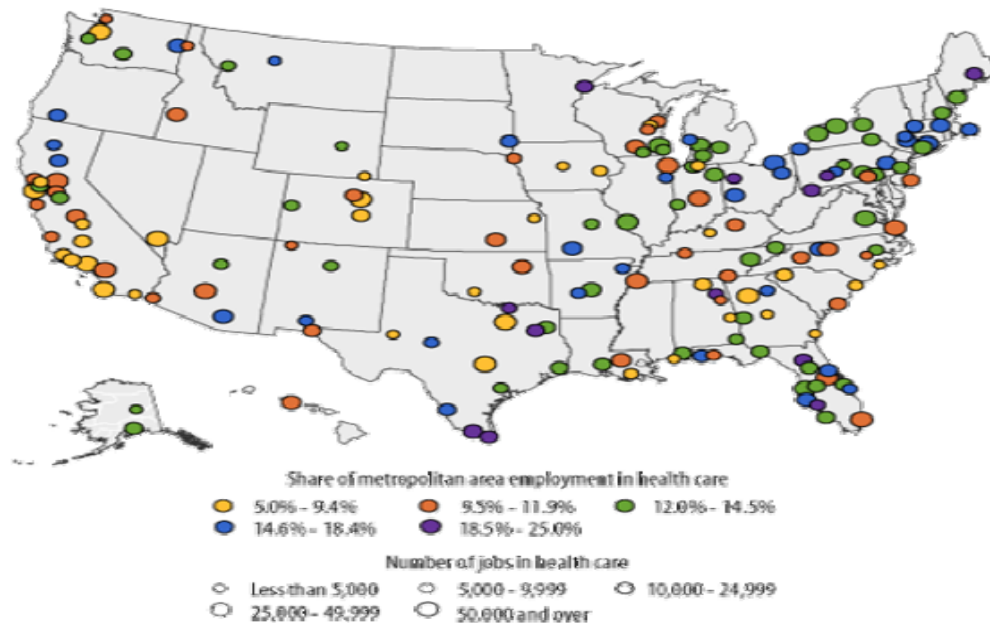
2. Economic Recovery

Pressure On Wages and Labor

Health Care Employment as % of Total Private Sector Jobs- 2008

Private-sector health care employment as a percentage of total private-sector employment

By metropolitan area, 2008



Source: U.S. Bureau of Labor Statistics

www.bls.gov

3. Reimbursement

- Going forward, more with less
- Medicaid cuts pending, some examples:

Examples of Medicaid Cuts: Hospitals

Arizona	5.0%
Florida	12%
Georgia	.5%
Nebraska	2.5%
Oregon	11.5%
Texas	8%

- Medicare most likely to be pressured at federal level
- Managed Care Compression

4. Variable Rate Debt

- Still renewal, remarketing, and put risk over the next few years
- Direct bank loans are taking some renewal capacity
 - No remarketing risk with direct bank loans, but interest rate risk present (if floating)
 - Fitch Ratings' Perspective of Private Placements:
 - Impact on the overall debt burden
 - Term out provisions
 - Renewal (put) date

5. Capital Needs

- Constrained Capital Spending
- Median average age of plant continued to increase in 2010
- IT pressures/ meaningful use

Fitch Education and Nonprofit Institutions Ratings

- 8 education and nonprofit institutions analysts
- 173 Education and Nonprofit Institution Rated Credits
 - 59 Public Colleges and Universities
 - 10 Community Colleges (revenue supported)
 - 49 Private Colleges and Universities
 - 28 Cultural and Other Nonprofit Institutions
 - 23 Charter Schools
 - 4 Privatized Student Housing

Fitch Education and Nonprofit Institutions Ratings

Portfolio of Rated Credits

	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>NIG</u>
Public Colleges and Universities	3	40	15	1	
Community Colleges (revenue secured)		5	4	1	
Private Colleges and Universities	4	8	14	18	5
Cultural and Nonprofit Institutions	2	10	12	4	
Charter Schools			3	18	2
Privatized Student Housing			1	2	1

Fitch Public Finance Higher Education Portfolio

2011 Outlook: **STABLE**

Predicated upon Fitch's expectation that the preponderance of rating activity within its universe of rated credits will take the form of affirmations, with individual credit outlooks remaining largely stable across the portfolio over the next 12 months.

Rating Actions

- 2.7%: Positive Outlook
- 92.7%: Stable Outlook
- 4.5%: Negative Outlook

Criteria for U.S. College and University Credit Analysis

- **Operational Effectiveness:** Including an institution's ability to effectively manage its enrollment base and position itself against competitors in the market
- **Demand Flexibility:** Particularly as it relates to an institution's ability to achieve enrollment goals without sacrificing student quality and/or tuition and fee revenue
- **Fundraising:** As a means for an institution to diversify its funding base away from student-related revenue sources
- **Revenue Diversity and Operating Margin:** Including an institution's sources of budgetary support and ability to prudently manage expenditures in line with revenue to ensure a stable margin over time

Criteria for U.S. College and University Credit Analysis, cont.

- **Balance Sheet Resources and Liquidity:** Notably, the degree to which such balances protect an institution from unexpected interruptions in core revenues and/or unexpected, significant increases in costs
- **Debt Burden:** With a focus on an institution's ability to service annual carrying charges from current operations

Top 5 Credit Risks

Facing Higher Education Institutions

1. State and Federal Financial Pressures

- Unknown impact of federal deficit reduction
 - Possibility of deep cuts to federally sponsored research and various student aid programs
- Possible loss of state aid (public universities)
 - Colleges and universities with a limited ability to backfill the loss of state aid could experience negative rating and/or outlook pressure

2. Student Demand and Enrollment

- Given student-generated revenue is the primary source of funding for most private universities, an institution's ability to meet current year enrollment targets is critical
 - Focus on enrollment management with targeted marketing and recruiting strategies
 - Price Sensitivity
 - Redirecting resources to financial aid

3. Complex Debt Structures

- More focused on debt and derivative policies mitigate a more aggressive capital structure
 - Debt and derivative policies which convey a college or universities understanding of risks attendant to various financial instruments and leverage strategies mitigates, to some extent, a more aggressive capital structure

4. Risk Management Practices

- Institutionalization of policies and practices to minimize risk
- Codification of best practices, including a comprehensive debt policy
- Importance of transparency

5. Debt

- Possibly a pent-up need for construction or capital spending
- Although many private colleges and universities restructured their debt over the last year, there is still variable rate debt exposure in the sector and the inherent renewal, remarketing, and put risk associated with variable rate debt
 - Liquidity facility expiration over the next few years

Questions?

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