STANDARD & POOR'S RATINGS SERVICES

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Highland Hospital Of Rochester, New York; Hospital

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Series 2005		
Long Term Rating	A-/Stable	Upgraded
New York State Dorm Auth, New York		
Highland Hosp of Rochester, New York		
Series 2010		
Long Term Rating	A-/Stable	Upgraded

Rationale

Standard & Poor's Ratings Services has raised its long-term ratings to 'A-' from 'BBB+' on New York State Dormitory Authority's $11 million series 2010 revenue bonds and Monroe County Industrial Development Agency, N.Y.'s $28 million series 2005 revenue bonds, issued for Highland Hospital of Rochester (Highland), reflecting recent and substantial balance sheet growth.

It is our opinion that Highland has a solid business position as a subsidiary of Strong Partners Health System, a subsidiary of the University of Rochester, of which Strong Memorial Hospital is a division. We also consider Highland's overall financial profile as increasingly strong. Highland's income statement performance has historically and consistently exceeded the 'A-' medians. However, until recently, certain balance sheet metrics remained well below 'A-' medians. Through fiscal 2011 and the first half of fiscal 2012 ended June 30, Highland's balance sheet has gained in considerable strength, and metrics, particularly cash to debt, are consistent with 'A-' levels, though days' cash on hand remained light for the rating through June 30, 2012. Since Highland invests unrestricted cash primarily in cash and short-term investments, we expect the recent balance sheet gains will be long term, with the growth rate dependent largely on future operating cash flows that are not subject to market volatility. Highland's healthy operating record lends weight to the expectation of continued balance sheet growth even as the organization continues to fund its pension plan and spend on capital renewal and replacement.

Additional rating factors that support our view include:

- Continued strong operating income since 2000, generating robust debt service coverage in fiscal 2010 and through the first half of fiscal 2012;
- Improving balance sheet metrics;
- Maintenance of a solid market share within the primary service area;
- A strategic affiliation with the University of Rochester ('A+') to carry out the medical center's mission, characterized by overlapping executive management; and

- Lack of additional debt plans during the next two years.

Partially offsetting credit factors include:

- A days' cash on hand metric that, while substantially improved, remained light for the rating as of June 30, 2012;
- An expected population decrease within the primary service area of Monroe County, which could constrain overall volume growth during the next several years; and
- Continued large annual pension funding requirements through 2017 that could limit the balance sheet growth rate, albeit at a lower level than previously expected.

A pledge of Highland Hospital's gross receipts secures the bonds. Highland Hospital is a 261-bed acute-care hospital located in Rochester. The University of Rochester is the sole member of Strong Partners Health System, which controls Highland and its affiliates, which include a for-profit pharmacy, a foundation, and a medical office building. Although Highland's debt is included in the university's consolidated financial statements, under the terms of the affiliation agreement, University of Rochester has no legal obligation to repay Highland's bonds. Highland is not a party to any swap transactions at this time. All of Highland's debt is fixed rate.

Management used series 2010 bond proceeds to fund the renovation of a patient unit to create a 22-bed neuromedicine inpatient unit, the construction of two additional operating rooms, and the purchase of surgical equipment and technology and to pay costs of issuance. The total cost of the project was $12.5 million, funded from bond proceeds and an equity contribution from cash flows. Management indicates the project was on time and on budget and opened in January of 2012.

While Highland has no plans for additional debt during the next two years, management is considering construction of an additional patient tower starting in 2015 at the earliest, for a total cost of up to $35 million. Management has not yet determined the final scope of the patient tower project, funding sources, or timing of the construction, and as such, we did not factor the capital expansion into the current rating. Based on the record of healthy operating performance, as well as recent and expected balance sheet growth, Highland could have the capacity to absorb a moderate additional debt issuance as it continues to fund its pension contributions. Despite the pension contributions and capital spending plans, management has added more than $30 million to Highland's balance sheet. Standard & Poor's will evaluate the effect of the potential debt and capital spending on Highland's financial profile and rating at the time of issuance and in light of further balance sheet and income statement growth.

Outlook

The stable outlook reflects our expectation that Highland's affiliation with Strong Partners Health System, coupled with continued cost controls and volume growth, will help maintain income statement strength at or near current levels during the next one to two years. We also expect that the continued healthy operating cash flows will further strengthen the balance sheet, particularly days' cash on hand, during the next one to two years, such that Highland can absorb its pension contributions and capital spending and create further capacity for potential future debt.

While not expected during the next one to two years due to the light days' cash-on-hand metric, we could consider a higher rating over time should Highland maintain profitability at or near current levels while sustaining at least 150 days' cash on hand. While not expected during the next one to two years due to the current levels of profitability and recent balance sheet growth, we could consider a negative outlook if Highland's profitability deteriorates significantly, or if balance sheet metrics decrease from current levels.

Enterprise Profile

Management

Highland Hospital, as an affiliate of Strong Partners Health System, a subsidiary of the University of Rochester, benefits from overlapping CEO, chief financial officer (CFO) and other senior management positions for Strong Memorial and Highland Hospitals. We believe the management team's length of service (more than 10 years) lends stability to the credit profile. We view Highland's financial management policies as strong, in part because Highland provides consolidated system audited financial statements and also consolidated system interim statements on a monthly basis and operating budgets on an annual basis. In addition to strong management and financial policies, we view Highland's affiliation with Strong Partners Health System as beneficial clinically because Highland renders primary, secondary, and some tertiary level treatment to alleviate constraints at Strong Memorial Hospital.

Market share and utilization

Highland's market share increased slightly to 17% in 2012 within the primary service area of Rochester, while Strong Memorial Hospital, a division of University of Rochester and the market leader, captured 35% of the market. Highland's historical volume growth is due to the strong integration of management and clinical services run under the university's auspices and the closure of both Genesee and St. Mary's hospitals in 2001. Without Highland, Strong Memorial would face tremendous capacity pressures across a variety of medical and surgical service lines. Therefore, Highland is a strategic part of the Medical Center's mission, which in addition to Strong Memorial Hospital, includes the School of Medicine and Dentistry, and the University of Rochester Medical Faculty Group. Other health facilities in the primary market are Rochester General Hospital, with approximately 30% market share, and Park Ridge Hospital, with 17% of the primary market.

The population within the primary service area of Monroe County was 728,987 in 2008, and projections indicate a decrease to 722,129 by 2013. Within the five-county total service area (Monroe, Genesee, Livingston, Ontario and Wayne counties), projections also show a decline in population between 2008 and 2013, though projections for Ontario County indicate growth. The decreased population within the service area could constrain future volume growth, though historical volume growth has been steady.

Discharges increased slightly in 2011 to 16,113 from 16,007 in 2010resulting from newly recruited surgical physicians. Emergency room visits increased to 36,547 in 2011 from 32,698 in 2010 due to recently recruited physicians in emergency medicine and the opening of an observation unit. Management expects volume growth to continue as it shifts additional clinical services to Highland from Strong Memorial, as well as offers new services in colorectal surgery, oncology, and neurosurgery. we also expect additional volume growth from the additional recently recruited physicians in vascular surgery, gynecological oncology, and emergency medicine, as well as the additional capacity as part of the project opened in January 2012.

Financial Profile

Income statement

Highland has posted healthy operating performance during the past several years largely because of increasing volumes and revenues, as well as effective cost controls. Operating income increased to a robust $18.8 million (6.6% margin) in fiscal 2011 beyond budgeted expectations, which was up from an already strong $14.8 million (5.4% margin) in fiscal 2010. The revenue growth in fiscal 2011 was due to increasing patient volumes and case-mix index growth, which produced greater reimbursement revenue. Through the first half of fiscal 2012 ended June 30, operating income remained strong at $6.6 million (4.5% margin), again, due to healthy patient volumes, solid managed-care reimbursement revenue, and cost controls. Management expects additional revenue growth to come from a recently approved Medicare Wage Index reclassification, which could represent an incremental $5 million in annual revenue. Management expects to earn $17 million from operations in 2012 due to revenue growth due to payment rate increases, volume growth, and cost controls.

Excess income increased to $19.7 million (6.9% margin) in 2011, from $15.7 million (5.6% margin) in 2010 due to the improved operating cash flows. Through the first half of 2012 ended June 30, excess income totaled $7.6 million (5.2% margin) due to the operating cash flow. We view debt service coverage as strong for the rating at 6x through the first half of 2012 ended June 30, compared with 6.4x in 2011 and a healthy 5.5x in 2010. We expect debt service coverage to improve during the next two years as the maximum annual debt service begins to decrease in 2013, and operating income remains at or near current levels. The debt burden was below average for the rating at 1.9% of revenues through the first half of 2012 ended June 30.

Balance sheet

After several years of being light for the rating, due in part to lighter investment returns, increasing pension contributions, and capital spending on information technology, Highland's balance sheet gained in strength in fiscal 2010 through the first half of fiscal 2012 ended June 30 due to healthy operating cash flows. Unrestricted cash increased substantially to $71.4 million (99 days' cash on hand) as of June 30, 2012, from a light $56.7 million (83 days' cash on hand) as of Dec. 31, 2010, compared with $31.6 million (50 days' cash on hand) on Dec. 31, 2008. Highland contributed $7.2 million to the pension fund in 2011, and expects to contribute an estimated $48 million to the pension fund during the next five years, or roughly $7 million to $12 million per year. Unrestricted cash to debt was strong for the rating at 199%, while leverage was light for the rating at 27% as of June 30, 2012.

Highland Hospital of Rochester & Subsidiaries Financial Statistics						
		--Fiscal year ended Dec. 31--			Medians	
	2012	2011	2010	2009	Stand-alone hospital A- 2011	Stand-alone hospital BBB+ 2011
Financial performance						
Net patient revenue ($000s)	137,509	263,031	259,455	249,947	274,811	263,859
Total operating revenue ($000s)	146,753	285,318	277,196	266,819	MNR	MNR
Total operating expenses ($000s)	140,134	266,489	262,339	256,811	MNR	MNR
Operating Income ($000s)	6,619	18,829	14,857	10,008	MNR	MNR

Highland Hospital of Rochester & Subsidiaries Financial Statistics (cont.)						
Operating margin (%)	4.51	6.60	5.36	3.75	1.90	2.50
Net nonoperating income ($000s)	991	866	828	407	MNR	MNR
Excess income ($000s)	7,610	19,695	15,685	10,415	MNR	MNR
Excess margin (%)	5.15	6.88	5.64	3.90	3.40	3.80
Operating EBIDA margin (%)	10.73	12.20	10.75	8.81	9.20	9.50
EBIDA margin (%)	N/A	12.47	11.02	8.95	10.20	10.60
Net available for debt service ($000s)	16,733	35,689	30,636	23,923	36,826	29,238
Maximum annual debt service ($000s)	5,598	5,598	5,598	5,598	MNR	MNR
Maximum annual debt service coverage (x)	5.98	6.38	5.47	4.27	3.60	3.20
Operating lease-adjusted coverage (x)	N/A	4.51	3.91	3.13	2.70	2.80
Liquidity and financial flexibility						
Unrestricted cash and investments ($000s)	71,427	66,147	53,813	45,117	131,743	95,495
Unrestricted days' cash on hand	98.8	95.8	78.9	67.2	182.60	148.20
Unrestricted cash/total long-term debt (%)	198.5	183.4	134.4	139.8	124.10	113.40
Average age of plant (years)	N/A	10.2	10.7	11.1	10.40	11.10
Capital expenditures/depreciation and amortization (%)	N/A	166.4	139.7	132.9	114.60	116.30
Debt and liabilities						
Total long-term debt ($000s)	35,986	36,065	40,029	32,273	MNR	MNR
Long-term debt/capitalization (%)	26.8	27.9	28.5	26.5	39.00	38.70
Contingent liabilities ($000s)	0	0	0	0	MNR	MNR
Debt burden (%)	1.89	1.96	2.01	2.09	3.10	3.10
Defined benefit plan funded status (%)	N/A	58.21	69.32	69.68	79.10	68.50

*Six-month interim data ended June 30. N/A--Not applicable. MNR--Median not reported.

Related Criteria And Research

USPF Criteria: Not-For-Profit Health Care, June 14, 2007