Fitch Ratings

Fitch Rates Memorial Sloan Kettering Cancer Center, NY's Rev Bonds 'AA'; Outlook Stable

Fitch Ratings-New York-06 December 2017: Fitch Ratings has assigned a 'AA' rating to $304.86 million series 2017-1 revenue bonds issued by the New York State Dormitory Authority on behalf of Memorial Sloan Kettering Cancer Center (MSKCC). Fitch also affirms the 'AA' rating on approximately $2.2 billion of outstanding debt listed at the end of the press release.

Bond proceeds will refund about $91.3 million series 2015-1 bonds and provide $243 million of funds for MSKCC's clinical expansion plan. The bonds are expected to sell via negotiated sale during the week of Dec. 18, 2017.

The Rating Outlook is Stable.

SECURITY

The bonds are unsecured obligations. There are funding events that would trigger springing collateral including a gross revenue and mortgage pledge of certain entities. The entities pledged for springing collateral vary under each bond resolution.

KEY RATING DRIVERS

SUPERIOR CLINICAL REPUTATION DRIVING DEMAND: MSKCC is one of the world's premier cancer care and research institutions and is consistently ranked as one of the best cancer hospitals in terms of quality outcomes and patient satisfaction. As a result of increased patient access and expanded capacity, the number of initial active patients increased 4% in 2016 and about 9% through the first nine months of 2017.

STRONG PHILANTHROPIC SUPPORT: MSKCC has strong fundraising abilities and philanthropy has been a consistent source of funds for operations, as well as capital needs. MSKCC has exceeded its $4 billion goal for its ongoing capital campaign and revenues from philanthropic activities remain robust at a total of $248 million in fiscal 2016 (Dec. 31 year-end) and $204.9 million for the nine months ending Sept. 30, 2017.

MAJOR CAPITAL SPENDING: MSKCC has been executing a clinical growth strategy with a significant investment in additional outpatient capacity and regional sites to capture growing demand. Approximately $996 million of capital spending remains for the clinical expansion plan until the end of 2019, with most of the funding derived from taxable bond proceeds that already have been issued. While MSKCC is issuing new money proceeds with the series 2017 financing, it plans to cash-defease $309 million of bonds, resulting in a net debt reduction by July 1, 2018.

GOOD CASH FLOW: MSKCC's operating performance remains good due to favorable reimbursement arrangements, a diversified revenue base with solid growth in patient revenues as well as research and royalty revenue. Operating cash flow has been robust and related ratios exceed Fitch's 'AA' category medians.

RATING SENSITIVITIES

MAINTAINING BALANCE SHEET STRENGTH: Fitch expects Memorial Sloan Kettering Cancer Center to maintain balance sheet metrics in line with 'AA' category medians, as it completes its major capital projects. If there is a material weakening in liquidity metrics, downward rating pressure could occur.

CREDIT PROFILE

MSKCC is the oldest and largest independent academic medical center exclusively focused on cancer care, research and education. MSKCC and Affiliated Corporations (consolidated entity) include the Cancer Center, Memorial Hospital for Cancer and Allied Diseases (477 operated beds), Sloan Kettering Institute for Cancer Research, SKI Realty, and MSK Insurance. Fitch's analysis is based on the consolidated entity. Total revenue in fiscal 2016 was $3.98 billion.

PREEMINENT ORGANIZATION

The 'AA' rating reflects MSKCC's strong clinical reputation as a leading provider of cancer care services, excellent philanthropic support and strong demand. Over 30% of MSKCC's patients are from outside New York State and it enjoys favorable patient satisfaction scores.

Management is implementing and executing a growth strategy to expand its capacity regionally, as well as grow its reach both nationally, through affiliations with other healthcare providers, and globally through the development of a cancer diagnostic and treatment tool. In addition to its growing Manhattan-based ambulatory care network, MSKCC has successfully developed four comprehensive outpatient locations in suburban locations outside of New York City and is constructing two more.

MSKCC has also formed a cancer alliance with three providers - Hartford Healthcare, Lehigh Valley Health Network and Miami Cancer Institute at Baptist Health South Florida - with the goal of expanding patient access to clinical trials, developing shared care models and generating royalty income.

MAJOR CAPITAL PROJECTS

MSKCC is in a period of heavy capital investments that are part of its clinical expansion plan. Fitch views these expansion plans favorably and expects the projects to be additive to operating cash flow as they are completed and operational, as has occurred with the several facilities that have already opened. Any cost overruns or extended delays that put stress on MSKCC's liquidity position could result in negative rating pressure.

Recent projects completed include an ambulatory care and surgery facility in Middletown, NJ that opened in 2016; an expansion to MSKCC's facility in Commack, NY; an expansion to its ambulatory facility in Basking Ridge, NJ; and a laboratory medicine building on East 64th St. in New York City.

Approximately 40% of the capital plan remains to be spent and includes completion of a 760,000 sf ambulatory care facility on East 74th St. in New

York City, an ambulatory care facility in Nassau County, NY, and an ambulatory care facility in Montvale, Bergen County, NJ, which are all slated to open in 2019.

The series 2015 taxable bonds and series 2016-2 tax-exempt bonds were the last issuances for the capital plan. Bond proceeds available for the clinical expansion plan total $911 million as of Sept. 30, 2017, with the balance being funded mostly through philanthropic giving and some internal liquidity. The projects will increase ambulatory care capacity by 40% and total costs have increased by about 10% since its inception, due to scope changes.

SOLID BALANCE SHEET

Unrestricted cash and investments totaled $4.65 billion at Sept. 30, 2017 and have remained largely stable over the past several years. MSKCC had 441.2 days cash on hand (DCOH), 36.3x cushion ratio, and 182% cash to debt at Sept. 30, 2017, compared to Fitch's 'AA' respective category medians of 254.1 DCOH, 29.4x cushion ratio, and 201% cash to debt. MSKCC also holds about $630 million of restricted funds to support operations.. Any weakening in MSKCC's unrestricted liquidity metrics could result in downward rating pressure.

DEBT POSITION

MSKCC's debt burden is moderately high for the rating category; however, Fitch expects this pressure on the financial profile to be temporary until more of the clinical expansion projects are completed and generate cash flow. In addition, MSKCC does not have any additional debt plans and existing tax-exempt bond amortization is relatively quick. Given the three bullet maturities in MSKCC's debt portfolio, pro forma maximum annual debt service (MADS) is approximately $193 million, assuming the bullet maturities are smoothed at a 5% interest rate over 30 years. Using this assumption, pro forma MADS coverage is moderate at 2.4x in fiscal 2016. However, coverage of actual annual debt service is very good at 5.5x in fiscal 2016 and 8.9x for the nine month period ending Sept. 30, 2017. Management anticipates using internal sinking funds for the bullet maturities of long-term debt.

MSKCC's pension liability has been decreasing as a result of increased contributions above minimally required amounts, the purchase of annuities for certain retirees and buy-outs for terminated vested non-retirees. As of Dec. 31, 2016, MSKCC's $257 million pension liability (82% funded ratio) decreased from $387 million (71%) two years earlier. The funded status is expected to decline further given strong investment returns and large contribution (about $185 million) made in the current fiscal year.

SOLID PROFITABILITY

MSKCC has experienced good profitability on a diversified revenue stream and enjoys favorable Medicare reimbursement, which accounts for about 25% of net patient service revenues. As a result of its position as a designated center from the National Cancer Institute, MSKCC is exempt from the Center for Medicare and Medicaid Services prospective payment system. Therefore, MSKCC enjoys more pricing flexibility on that component of its operations. Further, Medicaid accounts only for approximately 3% of its net patient service revenues.

Given the organization's fundraising capabilities, MSKCC has a policy of supporting operations with a portion of investment income and philanthropic proceeds. Total operating revenue in 2016 of $3.98 billion included $3 billion hospital care and medical practice revenue, $258 million of grants and contracts, $161 million of contributions allocated to operations, $86.8 million in net assets released from restriction, $167.7 million of royalty income, $137 million of investment returns allocated to operations and $75 million of other income. Fitch includes all these revenue sources in its operating ratios so they may not be comparable to those of other healthcare organizations.

Operating cash flow has been strong with operating EBITDA margins of 12.3% in fiscal 2016 and 13.4% for the nine months ended Sept. 30, 2017 compared to Fitch's 'AA' category median of 10.6%. Strong profitability has been mainly driven by strong growth in outpatient volume and a continued focus on costs.

DEBT PROFILE

As of Sept. 30, 2017, outstanding debt totaled $2.48 billion and is 100% fixed-rate with no swaps. MSKCC has a $400 million bullet maturity in 2042, a $400 million bullet maturity in 2052, and a $550 million bullet maturity in 2055. Fitch does not view these bullet maturities as a concern given MSKCC's access to the capital markets and management's plan to amortize the debt with internal sinking funds. Also, while MSKCC is issuing additional debt as part of the series 2017 bond issue, it plans to cash-defease $309 million of debt during fiscal 2018 which results in a net debt decrease.

Fitch has affirmed the following at 'AA':

--$550 million taxable bonds, series 2015A
--$400 million taxable bonds, series 2012A
--$262.3 million New York State Dormitory Authority revenue bonds, series 2012-1
--$84.2 million New York State Dormitory Authority revenue bonds, series 2012
--$400 million taxable bonds, series 2011A
--$368 million New York State Dormitory Authority revenue bonds, series 2008A-1 and A-2
--$137 million New York State Dormitory Authority revenue bonds, series 1998

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Applicable Criteria
Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017) (https://www.fitchratings.com/site/re/898969)
U.S. Nonprofit Hospitals and Health Systems Rating Criteria (pub. 09 Jun 2015) (https://www.fitchratings.com/site/re/866807)

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