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New York State Dormitory Authority
Memorial Sloan Kettering Cancer Center; Hospital

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Long Term Rating	AA/Stable	Affirmed
New York St Dorm Auth (Memorial Sloan Kettering Cancer Center)		
Unenhanced Rating	AA(SPUR)/Stable	Affirmed
Many issues are enhanced by bond insurance.		

Rationale

Standard & Poor's Ratings Services affirmed its 'AA' long-term rating and underlying rating (SPUR) on various series of New York State Dormitory Authority's health care revenue bonds, issued for Memorial Sloan Kettering Cancer Center (MSKCC). The outlook is stable.

The ratings reflect our view of MSKCC's:

- Very strong institutional characteristics, highlighted by demonstrated clinical quality, a large research base, and a leading market position in the broad, but fragmented, New York metropolitan oncology market;
- Historically strong balance sheet metrics that were negatively affected by the investment market's volatility in fiscal 2008 but that have rebounded nicely in fiscal 2009 with a 23% increase in unrestricted cash and a 17% increase in unrestricted net assets. Further improvements are evident as of the period ended Sept. 30, 2010,;
- Good revenue diversity, with patient care, research, fundraising, and royalties all contributing to a robust revenue stream that provides flexibility; and
- Strong financial planning, coupled with above-average financial flexibility that includes a strong payor mix, the flexibility to reduce expenditures through limiting research and clinical subsidies, and the capacity to increase demand by lifting current self-imposed limits on caseloads.

Partially offsetting credit considerations include:

- Volatile financial results, primarily due to MSKCC's high dependence on nonoperating income, with a larger operating loss (excluding investment earnings and contributions) in fiscal 2009 due to a combination of one-time items and some underlying operational pressure;
- Risks that are typical of a single-specialty institution, including changes in the provision of cancer care, and exposure to medical breakthroughs in cancer treatment;
- MSKCC's unfunded pension liability for the defined-benefit pension plan, which as of Dec. 31, 2009, had a $231 million unfunded liability or negative 35% funded status as a percent of the total benefit obligation, both vested and unvested;

- A large capital plan that totals approximately $2.4 billion over an eight-year period (2011-2018), although management has demonstrated an ability to reduce capital spending in a challenging financial environment; and
- A complicated legal structure that offers different springing security pledges for different bondholders, but is weak in certain respects--specifically, the rate covenant is not a true income statement test and permitted liens are very broad for a general obligation (GO) pledge.

Other credit factors include a conservative debt profile that consists of all fixed-rate debt, with no exposure to variable-rate debt or derivatives. MSKCC has $1.23 billion of long-term debt as of fiscal year-end 2010. Management's previous plans called for borrowing approximately $300 million in long-term debt and capital leases in 2009 or 2010 for partial funding of the center's $1.8 billion of expected capital spending during 2008 to 2012. However, given the volatility of the investment markets and generally weaker cash flow at that time, management reduced capital spending levels and delayed the financing. However, management has indicated that they have reassessed their long-range capital plan given the rebound in the investment markets and subsequent improvement in balance sheet metrics, which now calls for a large $2.4 billion in capital investment through 2018, with a potential debt issuance in the $500 million-$600 million range in 2012 or 2013.

Outlook

The outlook is stable. We believe MSKCC's operating and excess income can be quite volatile in any given year, as fiscal 2009 has shown, due to some underlying operational pressure and the uncertainty of investment returns and the philanthropic environment. While we believe operating losses have historically been manageable and understand they are planned as part of the normal business model, we have a negative view of the weaker fiscal 2009 results. Furthermore, in our view MSKCC has a robust capital plan and will likely need to improve operations and cash flow to support future debt increases and higher carrying charges over time.

In our opinion, MSKCC's still large balance sheet resources and management's operating flexibility (due to its ability to control certain discretionary patient services, if needed) balance these risks and lend stability to the current outlook. However, if operations remain pressured or weaken beyond current levels, or a large debt issuance weakens the financial profile, we could consider a negative outlook or lower rating.

Corporate Structure And Security Pledge

Memorial Sloan-Kettering Cancer Center is one of the three major entities forming MSKCC and its related corporations. The center holds the majority of the assets, including most of the endowments and unrestricted liquidity. The entities are the center, the Memorial Hospital for Cancer and Allied Diseases, and the Sloan-Kettering Institute for Cancer Research. Boards of overseers and managers that are virtually identical govern the three entities. Other entities include SKI Realty Inc. and two professional and general insurance companies. As the various entities are managed on a unified basis and the boards are almost entirely overlapping, Standard & Poor's analysis and all the figures cited in this analysis apply to the entire group of corporations, which is referred to as MSKCC. Furthermore, all financial calculations and ratios are presented based on Standard & Poor's guidelines, and may differ from the audited financial statement presentation.

MSKCC bonds are GOs of the center, guaranteed by the institute and the realty corporation. The hospital is not directly obligated on the bonds, but provides a negative pledge on its property and gross receipts. If MSKCC fails certain tests, springing collateral pledges--including gross receipts, pledges of portions of MSKCC, and springing mortgages--become activated until the tests are subsequently met. The specifics of the springing revenue pledges and the springing mortgages are different for each of the various series of bonds. The series share certain common security, although each also has unique collateral that is specific to the series individually. Simply, each series has its own security--the ratings on each are the same.

Operational Highlights

Net patient revenue (NPR) increased by 7.2% to $1.7 billion in 2009; while total operating revenue, which includes grants and contracts, royalty and other income, and net assets released for operational purposes increased just 4.1% to $2.07 billion. The operating loss widened to a sizeable $182 million partly due to operating expenses increasing 9.6% to $2.25 billion. Included in the above-average expense increase are costs of approximately $15 million associated with the opening and staffing of the new Breast and Imaging Center; and an approximately $30 million increase in the pension plan expense (the increased pension expense may occur for several years and is not necessarily a one-time item). Inpatient admissions increased 3.4% in 2009 to 23,469, and are up 10.9% since 2005. The hospital has historically increased volumes moderately, but they are relatively constrained from a capacity perspective. Outpatient visits are also growing, with total visits up 6.4% to 527,686. Part of the increase is due to changes in treatment protocols that affect the way treatment volumes are counted and the transition to a brand-new facility in Basking Ridge from a smaller facility in New Jersey in 2006. Nevertheless, management expects MSKCC's continued expansion to suburban centers outside New York City and the growing number of outpatient centers in MSKCC's historical hub in Manhattan will likely drive outpatient volume growth for the long term. Furthermore, the new Breast and Imaging Center, which came on line in late 2009 is also contributing to the volume growth as that facility ramps up.

Operating Results Decline In Fiscal 2009, Improvement Expected In Fiscal 2010

Operating results, exclusive of investment income and philanthropy, are typically negative, but in our view have remained manageable within a reasonable level and are historically offset by MSKCC's extensive philanthropic activity and sizable investment income. MCKCC operates using a spending policy that allocates a portion of investment income and contributions to operations; on that basis, MSKCC has remained profitable for many years. Looking purely at operations, excluding the investment income and contributions, MSKCC's operating loss in 2005 to 2008 was very stable, in a range of $66 million to $76 million annually. In fiscal 2009, the operating loss increased to $182 million, as MSKCC was hit with certain one-time nonrecurring items as well as some continued shifting to contracted managed-care agreements, which reduces revenue and profitability.

Standard & Poor's operating calculations exclude investment income and philanthropy, which historically have been substantial contributors to MSKCC's bottom line. In addition, Standard & Poor's excludes MSKCC's endowment-spending policy income from operations, which is a normal part of the center's operating budget. In essence, MSKCC's operating budgets are balanced, including endowment spending, which appears as an operating loss when adjusted by Standard & Poor's. We don't consider the presence of an operating loss a negative credit factor as long as the loss remains manageable within the context of MSKCC's nonoperating income sources, and as long as any significant increase in operating losses, as in fiscal 2009, are considered temporary and not a shift in the underlying operations or business model.

Bottom lines tend to be quite volatile due to the swings in operating income and the heavy reliance on investment income and philanthropy, as demonstrated in fiscals 2008 and 2009. In the past five years, net nonoperating revenue varied from $133 million to $321 million, and excess income ranged from negative $45 million to $245 million. In 2009, excess income of negative $45 million represented a negative 2% margin, below historical trends due to the majority of investment gains –- approximately $404 million, classified as unrealized versus realized. However, the total change in unrestricted net assets for fiscal 2009 was $412 million, compared with a negative $819 million in fiscal 2008 due to the investment portfolio generating $679 million of unrealized losses. Nine-month-interim results ended Sept 30, 2010, indicate continued operating losses, at $90 million, while nonoperating income (not adjusted for realized and unrealized gains) improves the excess income to $128 million.

Debt service, which includes the bond issues as well as various leases, peaks at approximately $108 million in 2013, then drops to $104 million in 2014 and then to the mid-$95 million range until 2023. Coverage of MADS in fiscal 2009 totaled 1.8x, down from 3x in fiscal 2008, while the nine-month-interim cash flow improves coverage to 3.6x, and management expects further improvement during the remainder of the fiscal year. The debt burden is above average, at 4.9% of revenue in fiscal 2009.

Liquidity Rebounds While Budgeted Capital Spending Levels Are Robust

Unrestricted cash reached $2.49 billion in fiscal 2009, up approximately 23% and rebounding from the 29% decline experienced in fiscal 2008, when cash fell to $2 billion due to the weak investment markets. As a result, days' cash on hand went from 394 in fiscal 2008 to 437 in fiscal 2009, while cash to debt increased from 169% to 203%, respectively. Unrestricted cash levels have improved again to $2.53 billion for the Sept. 30, 2010, period; however, days' cash on hand is down slightly to 426 due to the increase in the business and operating base. The investment allocation is in our view somewhat aggressive, with approximately 42% allocated to alternative investments with various lockup periods, while the remaining 58% is split between equities at 28% and fixed income and cash at 30%. While the alternative investment allocation is high, management has indicated that as of Sept. 30, 2010, roughly 50% of the $2 billion in total marketable assets can be liquidated in 30 days or less.

MSKCC spent $1.45 billion on capital in the past five years, averaging approximately 188% of its depreciation expense. Capital spending in fiscal 2009 totaled 132% of depreciation, which was the lowest level in five years. Management had deferred some projects due to the economic environment, but has since reassessed capital spending levels. In order to move forward with the long-term strategy, MSKCC has identified approximately $2.4 billion of capital spending over an eight-year period (2011 to 2018), although management has indicated the ultimate level of capital spending will hinge on future operating performance, fundraising, and strength of the balance sheet. The largest project is a $500 million expansion of the former Cabrini Medical Center on East 19th Street to an advanced ambulatory care center. MSKCC acquired the facility out of bankruptcy for approximately $83 million, and plans to renovate the entire facility to add more capacity and help accelerate the shift from inpatient to outpatient care. Other projects include an expansion of the ambulatory care facility in basking Ridge, N.J.; a new regional ambulatory care center, the second phase of a research building and various staff housing facilities.

In addition to the planned capital projects, MSKCC has entered into a joint venture with four other prominent New York City hospitals to build a New York Proton Beam Center. Management has indicated that the project received all necessary approvals in November 2010. Estimates on the project's cost are approximately $235 million, although management indicates that the total cost to MSKCC will be approximately $15 million and the debt associated with the project will be nonrecourse. Standard & Poor's will analyze the potential credit impact of the proposed financing structure, if any, once more details are known.

Funding sources for previous and future capital projects, in addition to bond proceeds, include operating cash flow and proceeds from an ongoing capital campaign. The capital campaign goal of $2 billion has been achieved, with $2.2 billion raised, and management indicates that it may increase the campaign goal to $3 billion. While the general environment for fundraising is under some pressure as characterized by the decline in fiscal 2009 contributions and pledges, MSKCC's fundraising capacity is among the best in the industry: It raised $166 million in 2009, $279 million in 2008, $239 million in 2007, and $298 million in 2006. Research revenue remains strong despite a weaker funding environment from the National Cancer Institute, which is part of the National Institutes of Health and represents the primary funding source for cancer research. Despite the research revenue growth, MSKCC still heavily subsidizes the cost of research at roughly $200 million annually. Research grants represent a relatively modest percentage of operating revenue (approximately 7% to 8%), but the research base is critical to recruiting the scientists and clinicians who drive the patient volumes, which generate the majority of revenue.

Royalty revenue, which is part of operating revenue, peaked in 2003 at $78 million and decreased steadily since then to $38 million in 2007. However, in fiscal 2008 there was an increase to $94 million due to the settlement of an outstanding patent royalty dispute. Royalty income leveled out at $62 million in fiscal 2009, although over the longer term, continued royalty income is dependent on scientific discovery.

The Organization

Memorial Sloan-Kettering Cancer Center consists of various integrated corporations (collectively referred to as MSKCC):

- Memorial Sloan-Kettering Cancer Center, which primarily provides support functions to the other corporations and manages them (also, most of MSKCC's investments are held at the center);
- Memorial Hospital for Cancer and Allied Diseases, which includes a 514-bed licensed hospital, outpatient clinical activity, clinical and translational research, medical education, and the physician practices;
- The Sloan-Kettering Institute for Cancer Research, where the basic and translational research is conducted;
- SKI Realty, which owns and manages residential and commercial real estate holdings;
- MSK Insurance Ltd., an offshore captive insurance company that primarily handles medical liability insurance for the family of corporations;
- MSK Insurance US Inc., which is a Vermont captive providing coverage for workers' compensation, certain general liability coverage, and certain property coverage for the family of corporations; and
- Louis V. Gerstner Jr. Graduate School of Biomedical Sciences, which is a graduate school of 60 graduate students seeking degrees in cancer biology.

The 29-member board is essentially identical across the principal entities (the first three above), which is a necessity, given the integrated nature of the various corporations' activities. For example, the center primarily provides support functions, but has no significant operating revenue stream of its own. Also, many physicians participate in both research and clinical care. The very impressive board membership includes several current and former CEOs of major corporations, as well as high-profile philanthropists. The experienced management team has a lot of depth and a good mix of longtime employees and newer people with strong outside experience.

The integrated nature of MSKCC's business model is a credit strength; all physicians are employed by MSKCC, which provides a captive referral base and a platform to standardize care pathways. Clinical care is provided by 18 disease-management teams, which integrate physicians and other caregivers from all the subspecialties related to a specific disease. This model provides care that is more integrated and has standardized clinical pathways. In addition, MSKCC has an advanced information technology (IT) system that maintains electronic patient records, test results, outcome measurements, and cost information on an integrated basis. Because of its organizational structure, IT systems, and high volumes of care, MSKCC demonstrates better outcomes than its competitors, including lower mortality rates and lower lengths of stay on a risk-adjusted basis.

Related Criteria And Research

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