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Illinois Finance Authority Rush University Medical Center Obligated Group; Joint Criteria; System

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Illinois Finance Authority (Rush University Medical Center Obligated Group)		
Long Term Rating	A-/Positive	Outlook Revised
Illinois Finance Authority (Rush University Medical Center Obligated Group) (MBIA) (National)		
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised
Illinois Fin Auth (Rush University Medical Center Obligated Group) hosp VRDO ser 2008		
Long Term Rating	AAA/A-1+	Affirmed
Unenhanced Rating	A-(SPUR)/Positive	Outlook Revised

Many issues are enhanced by bond insurance.

Rationale

Standard & Poor's Ratings Services revised its outlook to positive and affirmed the 'A-' long term rating on Illinois Finance Authority's $411.6 million series 2009A through 2009D fixed-rate hospital revenue bonds. S tandard & Poor's also revised it outlook to positive and affirmed the 'A-' underlying rating (SPUR) on the authority's $50 million series 2008A and $96.75 million series 2006B revenue bonds, all issued for the Rush University Medical Center Obligated Group (Rush). At the same time, Standard & Poor's affirmed its 'AAA/A-1+' dual rating on the authority's series 2008A variable-rate demand bonds (VRDBs), also issued for Rush.

The 'AAA/A-1+' dual rating on the series 2008A VRDBs is based on our joint criteria, with the long-term component of the rating based jointly on the Northern Trust Bank (AA) and Rush long-term ratings. The 'A-1+' short-term component of the rating is based on the Northern Trust short-term rating. The letter of credit expires December 2013.

The positive outlook reflects near completion of Rush University Medical Center's (RUMC) new patient tower (to open early in calendar 2012) and Rush's robust operating performance, which has helped to maintain a fairly stable balance sheet despite RUMC's recent period of major construction.

The 'A-' rating reflects the strength of RUMC, the obligated group's flagship hospital, as an academic medical center with well-defined market recognition despite concerns about competition. The rating also reflects RUMC's large net patient revenue base and robust operating income during the past five years. While capital spending will remain steady during the next few years, the opening of the new patient tower, Rush's largest project, is expected to open in early calendar 2012 and eliminates a major risk that has been part of Rush's profile for the past several years.

The 'A-' and positive outlook also reflect Rush's:

- Continued strong market recognition as an academic medical center with broad clinical services, extensive

education and research capabilities, and a solid market position in several key service lines in the competitive Chicago-area market;
- Track record of solid financial operations and cash flow, with unaudited fiscal 2011 results showing a strong operating margin of 5.6%, a solid EBIDA margin of 13.6%, and very good maximum annual debt service coverage of 4.2x; and
- Large net patient revenue base of $1.5 billion from serving two distinct market areas with modest inpatient growth offset by steady outpatient growth in recent years.

Credit risks, in our view, include Rush's:

- Final cash outlay for RUMC's new patient tower project in 2012 and ability to absorb the higher expense base at the same time that inpatient volume growth has slowed and the state Medicaid program is experiencing some pressure;
- Adequate, 137 days' cash on hand as of June 30, 2011 (with a minimum threshold of 115 during the next few years); and
- Location in the highly competitive Chicago service area, with RUMC in close proximity to three other hospitals in its immediate service area and with several other area academic medical centers and hospitals or health systems providing strong competition for key services.

The bonds secured under the master trust indenture are secured by Rush's gross revenues and mortgages on the main hospital facilities' property, plant, and equipment. Rush's total long-term debt, including capital leases, other financing arrangements, and guarantees, is $658 million, with most of this debt to be secured under the master trust indenture.

Rush's largest single project during the past few years has been the construction of a new patient tower at RUMC ($637 million). The new patient tower, which has been funded through bond proceeds, capital campaign contributions, governmental funding, and operating cash flow, is scheduled to open in mid-fiscal 2012. While Rush's capital expenditures will remain high at $238 million in 2012, capital spending should decrease thereafter but still remain steady at around $100 million annually as RUMC completes remaining renovations at its existing facilities through 2016. Moreover, the completion of and successful move into the new patient tower will eliminate a significant risk that has been part of Rush's profile for the past few years. In addition, some flexibility in the future capital spending plans should allow Rush to strengthen its currently light balance sheet profile should operations come under any unforeseen pressure away from currently strong levels. In recent years, RUMC and the smaller Rush-Copley Medical Center have generated strong operations, supported partially by the Illinois Provider Tax (IPT), but also through a very strong focus on strengthening key service lines as well as on operations and expense controls.

John Mordach is the new full-time Chief Financial Officer (CFO) at Rush and filled that position, which has been open since last summer, in early calendar 2011. He's held several senior finance positions including CFO at several hospitals and was most recently the CFO at Loyola University Health System in Maywood, Ill., (a neighboring suburb of Chicago).

Rush is party to two interest-rate swaps with a total notional amount of $96.75 million. Standard & Poor's has assigned Rush a Debt Derivative Profile (DDP) overall score of '1.5' on a four-point scale, with '1' representing minimal risk. The overall score of '1.5' reflects our view that Rush's swap portfolio poses a very low risk.

Outlook

The positive outlook reflects Rush's near completion of its major capital project at the same time that operations have remained strong and Rush has maintained its solid market position. If Rush is able to grow its balance sheet after final payments have been made for the new patient tower and absorb the higher expense base while continuing to make operating improvements as planned, Standard & Poor's could raise the ratings in the next year or two. Standard & Poor's could revise the outlook back to stable if the balance sheet shows limited growth with liquidity remaining at or near current levels. However, if operations experience sustained declines after the opening of the patient tower and margins remain below median levels, or operational liquidity levels decline and remain below Rush's floor of 115 days, the rating could be revised downward. Rush does not expect to issue any new-money debt during the next two years.

Operational Profile

The Rush health system consists of two medical centers in distinct service areas in the Chicago area:

- RUMC: A 664-staffed bed facility just west of downtown Chicago that also operates the 128-staffed-bed Rush Oak Park Hospital (ROPH) in the neighboring suburb of Oak Park; and
- Rush-Copley Medical Center (RCMC): Located in Aurora, Ill., a far-southwest suburb of Chicago, it serves as the parent holding company for Copley Memorial Hospital Inc. (a 210-staffed bed facility), Copley Ventures Inc., Rush-Copley Foundation, and Rush-Copley Medical Group NFP, all of which are Rush members.

Rush's operations include employed physicians as well as significant research and educational components such as Rush University, a health sciences university that includes Rush Medical College, College of Nursing, College of Health Sciences, and the Graduate College. Rush was created to diversify the revenue base that supports debt service, maximize debt capacity for the system, and generally strengthen overall creditworthiness. Although Rush is involved in some joint activities, the entities operate independently in terms of day-to-day activities and service delivery. However, management is focusing on how to strengthen collaboration clinically across its organizations and affiliates. RUMC's board exerts certain governance controls on the other entities' boards, which hold certain reserve powers through majority board representation. In 2011, Rush's admissions were down 2.5% relative to the prior year to 43,885; however, year-over-year outpatient volumes increased slightly by 0.5% to 442,088 and outpatient surgeries increased 2.6% to 29,664.

While RCMC generates positive operating income, RUMC -- Rush's largest component -- has helped Rush generate its strong financial performance in recent years. RUMC, which accounted for 88% of Rush's total assets, 83% of total revenues, and 85% of operating income as of fiscal year-end June 30, 2011, is in the Illinois Medical District with three other hospitals. It competes with four Chicago-area academic medical centers: Northwestern Memorial Hospital (AA+); University of Chicago Hospitals and Health System (AA-); Loyola University Health System; and University of Illinois Medical Center (A), as well as other suburban hospitals and systems. RUMC has well-known programs in orthopedics, neurology, neurosurgery, geriatrics, and kidney disease; and has generally maintained its 2.7% market share. The immediate service area and larger Chicago area remain competitive.

Admissions have flattened, similar to other markets and hospitals, although RUMC has continued to experience good outpatient growth through focus on certain key service lines and physician recruitment. Fiscal 2011 inpatient

acute care admissions were down 1.4% from the prior year to 27,568. However, in fiscal 2011 adjusted admissions at RUMC rose 1.6% to 49,143 with total surgeries stable at 26,329. RUMC has made slight gains more than the past few years in its market share to 2.7% in a very fragmented market. ROPH, which operates in a service area near RUMC, has become more closely integrated with RUMC's strategy and Rush has focused on strengthening certain key service lines across RUMC and ROPH. After a strong uptick in 2010, admissions at ROPH decreased slightly by 1% to 3,740 in 2011 but are still higher than 2009 levels.

RCMC is in a far-southwest Chicago suburb that has experienced favorable population growth, although recent economic challenges have negatively affected volumes in that market in addition to slowing growth. RCMC admissions were down 5.2% from the prior year to 12,577 in 2011. RCMC, however, maintains the leading market share, which has been growing, but decreased slightly in 2011 and is at 38.8%. Total adjusted discharges are up 3%, and surgeries increased about 1%, in fiscal 2011.

Finances: Positive Operating Income Trends In Recent Years

During the past five years, Rush has generated solid operating performance, with operating margins averaging 5.0% and operating cash flow margins averaging a healthy 11.9%. More specifically, unaudited fiscal 2011 generated $98.1 million (5.6% margin) of operating income, as compared with $89.4 million (5.3% margin) in fiscal 2010 (included in fiscals 2010-2011 operating income is the $23.0 million annual net payment from the IPT program that is approved through June 30, 2014). In addition to the solid outpatient volumes and the net payment from the IPT, management has made a concerted effort to manage its expenses and will continue efforts to do so during the next several years. Unaudited excess income of $114.4 million (6.5% margin) in fiscal 2011 was on par with the audited $101.6 million (6.0% margin) generated in fiscal 2010 due to the improvements from the investment markets. (We note that excess income excludes any gains or realized losses on discontinued operations, unrealized gains and losses on investments, changes in the fair value of interest-rate swaps as well as any gains/losses on sales, and losses on the extinguishment of debt.) Rush generated healthy 4.2x and 3.9x MADS coverage in fiscals 2011 and 2010, respectively.

According to its most recent plan from 2010, future operating and excess income margins should remain close to 2% and more than 5%, respectively, with EBIDA at 10%-12% to fund capital plans and begin to re-strengthen the balance sheet. Although management has operated within these targets for the past few years, the larger expense base, the general softness of the overall economy, and potentially lighter investment income required Rush to focus on core operations and key service-line enhancements. Management is updating its long-range financing plan to identify additional opportunities to strengthen its finances beyond current forecasts. Management is targeting an operating income of about $61.6 million in fiscal 2012, down from fiscal 2011 as the new patient tower is scheduled to open in mid-fiscal 2012.

Rush's balance sheet has remained relatively stable during the past year, despite increased spending for capital projects out of cash flow. However, balance sheet metrics could ease during the next year as management relies entirely on its own operating cash flow to complete and open its patient tower in 2012. Additionally, the state is experiencing some pressure and may delay payments to Rush as the year continues; Rush has a total of $150 million in two lines of credits as a back up to help manage any excess pressure related to receivables. As mentioned above, the largest-single project in Rush's capital plans is the new patient tower, which totals $637 million; to date, Rush has spent about $437 million on that project. There are other smaller projects scheduled to be completed during the

next few years, including an expansion of RCMC's ambulatory facility in Yorkville (to open in 2012), but many of these smaller projects can be modified if necessary.

Management does not expect unrestricted cash to grow significantly during the next year given the scheduled completion of RUMC's patient bed tower; however days' cash on hand is expected to be no less than 115 days' during the next year or two and could likely be higher given management's focus on strengthening operations. There also should be less volatility in Rush's unrestricted cash position because much of its unrestricted cash resides in fixed-income securities and cash. At fiscal year-end 2011, Rush increased its unrestricted liquidity to $568.8 million (or 137 days' cash on hand) and leverage was down slightly to 42.9% with cash to long-term debt at 86%. Unrestricted cash has been adjusted to incorporate any difference between the full self-insurance liability and the reserves already set aside by Rush for that liability on its financial statements.

Rush is compliant with all of its covenants.

Debt Derivative Profile: Very Low Risk

Rush's overall DDP score of '1.5' reflects our view that its swap portfolio poses a very low risk. Specifically, Rush's DDP score reflects:

- A moderate termination risk, given the swaps' long maturity dates;
- The system's excellent management oversight of its derivatives policies;
- A low counterparty risk due to the counterparties' strength and full counterparty collateralization should the long-term ratings on the counterparties decline to 'BBB+'; and
- The swap portfolio's moderate economic viability risk.

Rush is party to two floating- to fixed-rate swaps on a total notional amount of $96.75 million. The counterparties on the swaps are Morgan Stanley Capital Services Inc., with a guarantee by Morgan Stanley (A+) and Citibank N.A. (AA). As of June 30, 2011, the market value of the swaps was a liability of $14.5 million, down from $16.9 million at the end of fiscal 2010. No collateral posting is required unless the market value of the swap increases to a liability above $25.0 million at the current rating level. Rush is using $50.0 million of the interest rate swaps outstanding to synthetically fix the interest rate on the series 2008A VRDBs and the remaining swap notional amount was unhedged. Total net variable-rate debt as a percentage of total debt, including the swaps, is 0%.

Related Criteria And Research

- USPF Criteria: Not-For-Profit Health Care, June 14, 2007
- USPF Criteria: Debt Derivative Profile Scores, March 27, 2006
- Criteria: Joint Support Criteria Update, April 22, 2009