**Moody’s**

**INVESTORS SERVICE**

**New Issue:** Moody’s assigns A1 rating to Rush University Medical Center Obligated Group (IL) Series 2015A&B bonds; outlook stable

Global Credit Research - 09 Jan 2015

$552M rated debt to be outstanding

ILLINOIS FINANCE AUTHORITY
Hospitals & Health Service Providers
IL

**Moody’s Rating**

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<td>Series 2015A Fixed Rate Revenue Bonds</td>
<td>A1</td>
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<td>Sale Amount</td>
<td>$410,470,000</td>
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<td>Expected Sale Date</td>
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| Series 2015B Fixed Rate Revenue Bonds | A1 |
| Sale Amount | $91,440,000 |
| Expected Sale Date | 01/14/15 |
| Rating Description | Revenue: Other |

**Moody’s Outlook** STA

NEW YORK, January 09, 2015 --Moody’s Investors Service has assigned an A1 rating to Rush University Medical Center Obligated Group's, IL (Rush) $410.5 million of Series 2015A and $91.4 million of Series 2015B fixed rate revenue bonds. The bonds are to be issued by the Illinois Finance Authority. At this time we have upgraded Rush’s existing rated debt to A1 from A2 affecting $551 million of rated bonds outstanding (see Rated Debt section). The outlook is revised to stable from positive at the higher rating level.

**SUMMARY RATING RATIONALE**

The upgrade to A1 reflects Rush’s track record of double-digit operating cash flow margins in recent years, improved liquidity ratios, and good pro forma debt coverage ratios. The stable outlook at the higher rating level reflects our expectation that Rush will continue to generate favorable operating margins and maintain liquidity strength, as well as our understanding that Rush does not plan to issue material new debt in the near/immediate term. Offsetting these strengths, Rush operates in a very competitive market with multiple prominent academic medical centers (AMC), somewhat challenging payer environment, and challenges presented by the State of Illinois’ budget.

**STRENGTHS**

*Rush is anchored by a sizeable AMC with a broad array of tertiary and quaternary services and ambulatory locations throughout the Chicago area.

*Rush has a track record of profitability with six consecutive years of double digit operating cash flow margins and particularly strong results in FY 2013 and FY 2014.

*Rush is one of the few health systems in the Chicago area whose inpatient volumes are growing. We expect that, given market realities and changing industry dynamics, Rush’s rate of inpatient volume growth will slow in the coming years.
*Rush's pro forma adjusted debt ratios are favorable (6.4 times maximum annual debt service (MADS) coverage).

*Rush's liquidity ratios have improved in recent years, as cash on hand measured an adequate 210 days at FYE 2014. Furthermore, Rush holds significant restricted cash, which bolsters the balance sheet.

*Rush's near-term capital spending plans are manageable and we do not anticipate additional leverage added over the near term.

CHALLENGES

*Rush operates in a very competitive healthcare market in the Chicago area, with four competing AMCs and other sizeable health systems.

*Given its academic mission, Medicaid is above average (16.9% of gross revenues in FY 2014, compared to all ratings median of 13.0%), which is of particular concern in Illinois given the state's budget challenges.

* Longer-term, Rush may consider new debt options to support capital spending plans that are being considered over a multiyear period.

DETAILED CREDIT DISCUSSION

USE OF PROCEEDS: Proceeds from the issuance of the Series 2015A&B fixed rate bonds will be used to refund Series 2009A,B,C,&D and Series 2006B fixed rate bonds and pay the costs of issuance. As part of the plan of finance, Rush expects to release the debt service reserve funds (DSRF) currently in place to support the Series 2006B and Series 2009 bonds. The Series 2015 bonds are not expected to be supported by a DSRF.

LEGAL SECURITY: The bonds are expected to be secured by a gross revenue pledge of the Rush Obligated Group, which includes 677 staffed bed Rush University Medical Center (RUMC), 210 staffed bed Rush-Copley Hospital (Rush-Copley), and 128 staffed bed Rush-Oak Park Hospital (Rush-Oak Park). Violating historical debt service coverage rate covenant of 1.1 times requires hiring of consultant in most cases. Additional debt tests include: (1) minimum pro-forma debt service coverage of 1.10 times; or (2) minimum historical debt service coverage of 1.1 times.

INTEREST RATE DERIVATIVES: Rush has two fixed payer swaps, one with Morgan Stanley Capital Services, Inc. and one with Citibank, N.A. with a combined notional amount of $92.7 million. The swaps expire in November 2035. Under the agreements, Rush pays a fixed interest rate of 3.945% and receives 68% of LIBOR. Based on management data, the total net termination value of the swaps is a negative $19.2 million to Rush. Rush's collateral posting requirement on the Citi swap is a negative $12.5 million and negative $12.5 million on the Morgan Stanley swap; no collateral currently is posted.

MARKET POSITION/COMPETITIVE STRATEGY: INCREASING SHARE OF VERY COMPETITIVE MARKET

Rush operates in a very competitive market, as the Chicago area includes four additional AMCs and multiple sizeable health systems that are embarking on various strategies to gain inpatient and outpatient market share and prepare for new payment methodologies. Competing AMCs include Northwestern Memorial HealthCare (Aa2 stable), University of Chicago Medical Center (Aa3 negative), University of Illinois Health Services Facilities System (A2 Negative), and Loyola University Medical Center (which is owned by Trinity Health Credit Group, Aa2 negative). Other prominent health systems include market share leader Advocate Health Care Network (Aa2 stable), NorthShore University HealthSystem (Aa2 stable), Presence Health (Baa2 stable), and Alexian Brothers Health System (A2 stable and owned by Ascension Health Alliance, Aa2).

Since opening its new patient tower in January 2012, RUMC has gained market share, increasing to 3.2% inpatient share of an eight-county service area (based on management data), making RUMC the third largest hospital in the broad market.

While Rush-Copley and Rush-Oak Park also operate in competitive local service areas, both are the market share leader each respective service area. Rush-Copley's service area centers around Aurora, IL in growing Kendall County. Rush-Oak Park's service area centers on Oak Park, IL, just west of the City of Chicago, directly west of downtown Chicago.

OPERATING PERFORMANCE: STRONG RESULTS IN RECENT YEARS

Favorably, Rush has recorded double-digit operating cash flow margins for six consecutive fiscal years.
Performance was particularly good in FY 2013 and FY 2014 (June 30 year end), when Rush recorded adjusted operating cash flow margins of 12.2% and 12.1%, respectively (adjusted to reclassify the portion of investment income included in operating revenue to non-operating; FY 2013 adjusted to include $10.6 million of operating expenses for a favorable FICA settlement). The A1 median operating cash flow margin is 10.4%.

Factors contributing to continued strong results in FY 2014 include: inpatient admission growth (up 0.5%; admissions were up 1.9% including observation stays), which is particularly noteworthy in the current environment where volumes at most area hospitals are down; improved labor productivity, due in part to the new RUMC patient tower; a clinical resource management program to reduce variation in clinical practices and improve operational efficiency; and supply cost savings.

Looking forward, management expects Rush's adjusted operating cash flow margin to be sustained in the 11.5% to 12.5% range. While we believe that Rush may be challenged to match the particularly good results achieved in FY 2013 and FY 2014, the stable outlook at the higher rating level reflects our belief that Rush is positioned to maintain an operating cash flow margin at least in-line with A1 medians. In addition to improvement efforts noted above, future results are expected to benefit from pension expense and interest expense savings. Through three months FY 2015, Rush's operating margins were very strong, with an adjusted operating margin of nearly 13%.

**BALANCE SHEET: IMPROVED LIQUIDITY, FAVORABLE DEBT RATIOS, AND MANAGEABLE CAPITAL SPENDING PLANS**

Rush's liquidity position has improved considerably in recent years. Absolute unrestricted cash and investments increased to $1.02 billion (210 days cash on hand) at FYE 2014 from $850 million at FYE 2013 (189 days) (A1 median is 227 days). At FYE 2014, Rush's unrestricted cash and investments were allocated among approximately 68% cash and fixed income securities, 19% equities, and 13% other investments, and 100% of unrestricted cash and investments could be liquidated within one month. Rush's balance sheet is bolstered further by $515 million of restricted cash and investments as of FYE 2014.

Rush's adjusted pro forma debt coverage ratios are favorable at the A1 rating level. Based on FY 2014 results and including the Series 2015A&B refunding bonds, adjusted debt-to-cash flow measures 2.4 times (A1 median is 3.0 times), MADS coverage measures 6.4 times (A1 median is 5.1 times), debt-to-total operating revenues measures 33% (A1 median is 37%), cash-to-direct debt measures 157% (A1 median is 151%), and monthly liquidity-to-demand debt measures 1,062% (A1 median is 371%). Factoring direct debt, operating leases, and Rush's cash balance defined benefit pension plan, Rush's pro forma cash-to-comprehensive debt measures 120% (A1 median is 124%).

Rush's capital spending plans in the near/immediate term are manageable. Between FY 2015 and FY 2019, Rush has approximately $670 million of capital plans, translating to an average capital spending ratio of just under 1.1 times (the all ratings median is 1.2 times). Rush does not have new money debt plans over the period, which is a factor in the stable outlook at the A1 rating level. Rush is in the process of updating its long-term master facility plan, however; capital spending plans may increase in the longer-term, which may include new money debt in the out-years.

**OUTLOOK**

While we do not necessarily expect Rush to match the level of margins recorded in FY 2013 and FY 2014, the stable outlook at the A1 rating level reflects our expectation that Rush will continue to generate favorable operating margins and maintain liquidity strength. Also, the stable outlook incorporates our expectation that Rush does not plan to issue material new debt in the near/immediate term.

**WHAT COULD CHANGE THE RATING UP**

Further upgrade of the rating may be considered if Rush demonstrates continued notable organic growth while sustaining solidly double-digit operating cash flow margins and improved debt coverage and liquidity ratios.

**WHAT COULD CHANGE THE RATING DOWN**

A downgrade may be considered if Rush's operating margins deteriorate materially, particularly for a sustained period. Also, a material increase in debt without commensurate increase in cash flow and liquidity could lead to a downgrade.

**KEY INDICATORS**
Assumptions & Adjustments:

- Based on Rush University Medical Center Obligated Group consolidated financial statements
- First number reflects audited FY 2013 for the year ended June 30, 2013
- Second number reflects pro forma on audited FY 2014 for the year ended June 30, 2014
- Pro forma assumes issuance of Series 2015A&B fixed rate revenue bonds to refund Series 2006B fixed rate bonds and Series 2009A,B,C,&D fixed rate bonds
- FY 2013 adjusted to increase operating expenses by $10.6 million to account for Rush's favorable FICA settlement
- Investment returns reclassified as non-operating and normalized at 6% unless otherwise noted
- Comprehensive debt includes direct debt, operating leases, and pension obligation, if applicable
- Monthly liquidity to demand debt ratio is not included if demand debt is de minimis

*Inpatient admissions: 49,539; 49,804
*Observation stays: 12,808; 13,716
*Medicare % of gross revenues: 34.6%; 34.6%
*Medicaid % of gross revenues: 16.9%; 16.9%
*Total operating revenues ($): $1.82 billion; $1.96 billion
*Revenue growth rate (%) (3 yr CAGR): 4.0%; 5.6%
*Operating margin (%): 2.6%; 4.4%
*Operating cash flow margin (%): 12.2%; 12.1%
*Debt to cash flow (x): 2.77 times; 2.38 times
*Days cash on hand: 189 days; 211 days
*Maximum annual debt service (MADS) ($): $56.9 million; $47.4 million
*MADS coverage with reported investment income (x): 4.51 times; 5.53 times
*Moody's-adjusted MADS Coverage with normalized investment income (x): 4.95 times; 6.38 times
*Direct debt ($): $663 million; $647 million
*Cash to direct debt (%): 128%; 157%
*Comprehensive debt: $884 million; $849 million
*Cash to comprehensive debt (%): 96%; 120%

RATED DEBT

Issued through Illinois Finance Authority (debt outstanding as of June 30, 2014):
- Series 2009C&D Fixed Rate Hospital Revenue Bonds ($200.0 million outstanding; expected to be refunded by Series 2015A&B fixed rate bonds), rated A1
- Series 2009A&B Fixed Rate Hospital Revenue Bonds ($208.6 million outstanding; expected to be refunded by Series 2015A&B fixed rate bonds), rated A1
- Series 2008A VRDO Hospital Revenue Bonds ($50.0 million outstanding), supported by a direct-pay LOC from Northern Trust Company and rated Aa2/VMIG1 reflecting Moody’s approach to rating jointly supported
transactions) (the LOC expires in February 2017), A1 underlying rating

-Series 2006B Fixed Rate Hospital Revenue Bonds ($92.8 million outstanding; expected to be refunded by Series 2015A&B fixed rate bonds), insured by National Public Finance Guarantee Corp (MBIA), rated A1

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Not-for-Profit Healthcare Rating Methodology published in March 2012. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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