Fitch Ratings-Chicago-10 December 2018: Fitch Ratings has assigned an Issuer Default Rating (IDR) of 'AA-' to Rush University Medical Center Obligated Group (Rush System for Health). Fitch also has upgraded to 'AA-' from 'A+' the ratings on approximately $466 million of series 2015A&B fixed rate revenue bonds issued on behalf of Rush by the Illinois Finance Authority. The Rating Outlook is revised to Stable from Positive at the higher rating level.

SECURITY

Bond payments are secured by a pledge of the gross revenues of the obligated group. The obligated group includes the vast majority of Rush operating assets, including the Rush University Medical Center (RUMC) flagship as well as Rush's two community hospitals: Rush Oak Park Hospital (Rush Oak Park, located in Oak Park, IL) and Rush Copley Medical Center (Rush Copley, located in Aurora, IL).

ANALYTICAL CONCLUSION

The upgrade of Rush's revenue bond rating to 'AA-' from 'A+' is due in part to continued liquidity growth and improved capital-related ratios. The 'AA-' rating is attributable to Rush's strong financial profile assessment combined with the system's mid-range revenue defensibility and strong operating risk profile assessments. While operating in a competitive metropolitan service area, Rush has a broad reach for high-acuity services as a leading academic medical center (AMC). The Stable Outlook at the higher rating level reflects Fitch's expectation that Rush will sustain strong operating margins consistent with its historical track-record and maintain and build liquidity over time. Capital-related ratios should be strong, including through-the-cycle in Fitch's stressed rating case.

KEY RATING DRIVERS

Revenue Defensibility: 'bbb'; AMC with Broad Reach in Very Competitive Market

Rush's revenue defensibility is midrange. The system operates in a market with a number of competing AMCs, as well as other health system's with tertiary services. Rush's payor mix is sound and, the local service area is stable.

Operating Risk: 'a'; Track-Record of Strong Operating Margins

Rush's operating risk profile is strong. The system is expected to maintain an operating EBITDA margin above 9%. While capital spending is expected to be robust, Fitch considers Rush's plans to be flexible.

Financial Profile: 'aa'; Strong Capital-Related Ratios through the Cycle

Rush's financial profile is strong. Capital-related ratios strong through the cycle in Fitch's FAST scenario analysis stressed rating case.

Asymmetric Additional Risk Considerations

There are no asymmetric risk factors associated with Rush's rating.

RATING SENSITIVITIES

SUSTAINED OPERATIONS; DEBT Capacity: Fitch expects Rush to sustain an operating EBITDA margin consistent with a strong operating risk assessment. Capital-related ratios should remain strong, including through the cycle in Fitch's stressed rating case. Issuance of debt materially in excess of what Rush has planned, or failure to sustain operating margins could pressure the rating. Near-term additional upward rating movement is not likely.

CREDIT PROFILE

Rush operates the RUMC AMC in Chicago (just west of the Loop) and two community hospitals located in the western suburbs: Rush Oak Park in Oak Park and Rush Copley in Aurora. Additional operations include a medical group with over 700 employed physicians, a rehabilitation and skilled nursing facility, research facilities, a university with approximately 2,700 students (all graduate), and a graduate medical education program. Rush is unique among academic medical centers in that the hospital founded the university and both entities are under a common governance and management structure. Rush System for Health recorded just over $2.4 billion in total operating revenues in fiscal 2018. Rush is a part of the Illinois Medical District along with the University of Illinois Hospital & Health Sciences, the John H. Stroger, Jr Hospital (a member of the Cook County Health and Hospitals System), the Jesse Brown VA Medical Center, and other healthcare entities.
Revenue Defensibility
Rush's payor mix is midrange. Combined Medicaid and self-pay accounted for roughly 22% of gross revenue in fiscal 2018. Illinois expanded Medicaid under the Affordable Care Act (ACA).

Rush's service area is very competitive and covers the broad Chicago metro area. In that broad region, the leading individual hospitals are Northwestern Memorial Hospital (the flagship of Northwestern Medicine) and Advocate Christ Medical Center (a member of 'AA' rated Advocate Aurora Health), each with 4.7% market share (based on management data). RUMC captures 3.2% share. In addition to RUMC and Northwestern Memorial, AMC competitors include the University of Chicago Medical Center (rated 'AA-'), University of Illinois Hospital & Health Sciences (UI Health, like RUMC, is a part of the Illinois Medical District), and Loyola Medicine (a member of 'AA-' rated Trinity Health). Moreover, the market includes diversified health systems, including the aforementioned Advocate Aurora Health and Trinity Health as well as NorthShore University HealthSystem, Ascension Health (rated 'AA+'), Edward-Elmhurst Healthcare (rated 'A'), among others. Due to the unique and highly fragmented market, Fitch considers Rush's market position to be comparatively weaker relative to industry peers operating in less competitive areas.

More positively, Rush Copley is the leader in its service area around Aurora, IL, in the western suburbs. Rush Copley captured nearly 36% share in fiscal 2018, followed by Presence Mercy Medical Center (a member of Ascension Health) with 16% and Edward Hospital (a member of Edward-Elmhurst Healthcare) with 15%.

Rush exhibits strong quality indicators, which, in Fitch's opinion, bolster its overall revenue defensibility. For example, RUMC was ranked by Vizient as the second best AMC in the country by quality (behind only the Mayo Clinic) among 99 AMCs measured (RUMC has been ranked in the top five every year since 2013).

Rush's service area economy is stable. As a major metro area, Chicago benefits from a diversified economy. Population trends in Cook County are stagnant, although Kane County (where Rush Copley is located) is growing. The median household income level in Cook County is just above the national average, while well above average in Kane County. The unemployment rate in the Chicago-Naperville-Elgin metropolitan statistical area is just above the national average. Fitch does not expect Rush's payor mix to change materially in the coming years.

Operating Risk
Rush's operating cost flexibility is strong. The system's operating EBITDA margin averaged nearly 10% between fiscal 2016 and 2018, including 9.9% in fiscal 2018. Fiscal 2018 benefited from good outpatient growth, including total outpatient visits (up 7.4% over fiscal 2017), outpatient surgeries (up 3.1%), and unique patients (up 18.3%), which helped to offset a 0.5% decline in inpatient admissions (-0.8% inclusive of observation stays). Rush also implemented a Lean efficiency process that has yielded a decline in average length of stay (ALOS) from 5.04 days in fiscal 2017 to 4.92 days in fiscal 2018.

Looking forward, Fitch expects Rush to sustain an operating EBITDA margin in the 10% range in the coming years. Management is implementing further Lean efforts, including at least $10 million of non-labor savings as well as labor efficiencies.

Rush's capital spending requirements are manageably elevated. The system has just under $1.2 billion of capital spending planned between fiscal 2019 and fiscal 2023, translating to an average annual capital spending spending ratio of roughly 1.7x (spending is front-loaded, as the capital spending ratio will average approximately 2.2x). While capital spending is expected to be robust, Fitch considers Rush's plans to be flexible. Future capital is focused on ambulatory development. For example, the system is expected to open a major outpatient center in Oak Brook in January 2019 (in partnership with Midwest Orthopedics), following the recently opened River North and South Loop (opened October 2018) outpatient centers in the City of Chicago. Rush is also planning a major new ambulatory building on the RUMC campus, a project for which the system is contemplating a debt issuance, perhaps in fiscal 2020. Rush's average age of plant measured 11.9 years at fiscal year-end 2018 (the 'AA' category median is 10.4 years).

Financial Profile
Rush's financial profile is strong. Capital-related ratios are strong through the cycle in the stressed rating case of Fitch's FAST scenario analysis, given the system's midrange revenue defensibility and strong operating risk profile assessments.

Rush had approximately $700 million of debt at audited fiscal year-end 2018 (June 30 year-end). Unrestricted cash and investments measured nearly $1.3 billion fiscal year-end 2018, at which point Rush also had more than $700 million of restricted investments.

Debt equivalents are manageable. Rush has a defined benefit (DB) pension plan. The DB plan was 98% funded at fiscal year-end 2018 relative to a projected benefit obligation (PBO) of just over $1.0 billion. (Fitch only includes the portion of FASB DB pensions that are below 80% funded in the calculation of adjusted debt.) Rush's operating lease expense measured just over $33 million in fiscal 2018, translating to a debt equivalent of under $170 million (based on 5x lease expense method). Consequently, Rush's adjusted debt (direct debt plus underfunded DB pension below 80% funded plus operating leases) measured approximately $865 million at fiscal year-end 2018. Net adjusted debt (adjusted debt minus unrestricted cash and investments) measured nearly negative $435 million. Favorably, Fitch expects net adjusted debt to remain negative through the cycle over the next five years.

Per Fitch's FAST scenario analysis, Rush's capital-related ratios should remain strong through the cycle, including in the stressed rating case. Based on fiscal 2018 results, Rush's net adjusted debt-to-adjusted EBITDA measured a favorably negative 1.4x and cash-to-adjusted debt 150%. Through the five-year cycle in the stressed rating case (which assumes normal economic recession followed by a recovery and then stability), net adjusted debt-to-adjusted EBITDA remains negative throughout the cycle while cash-to-adjusted remains near 120% throughout and exceeds 120% by year four.
Asymmetric Additional Risk Considerations

There are no asymmetric risk factors associated with Rush's rating.

Unrestricted cash and investments measured nearly $1.3 billion at fiscal year-end 2018. Cash on hand measured over 210 days and does not pose an asymmetric risk.

Rush had nearly $700 million of debt at fiscal year-end 2018. Debt includes approximately $85 million of variable rate securities, including $35 million of series 2011 private placement debt $50 million of series 2016 variable rate bonds. Maximum annual debt service (MADS) is $46.6 million. MADS coverage based on fiscal 2018 is 5.6x and does not pose an asymmetric risk.

Rush's financial covenants include minimum MADS coverage of 1.20x, minimum historical debt service coverage of 1.10x, and minimum cash on hand of 65 days.

Rush has two fixed payor swaps, with a notional amount of approximately $79 million. The net termination value of the swaps was a negative $11.6 million to Rush at fiscal year-end 2018 (no collateral was posted at year-end). The swaps expire in November 2035.

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