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Maine Health & Higher Educational Facilities Authority
Eastern Maine Medical Center; Hospital

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Maine Health & Higher Educational Facilities Authority
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Credit Profile		
Maine Hlth & Hgr Educl Facs Auth, Maine		
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Series 2013 Bonds		
Long Term Rating	BBB/Stable	Affirmed

Rationale

Standard & Poor's Ratings Services affirmed its 'BBB' long term rating on Maine Health and Higher Educational Facilities Authority's $143.7 million series 2013 bonds issued for Eastern Maine Medical Center (EMMC) Obligated Group, a component of Eastern Maine Healthcare Systems (EMHS). The outlook is stable.

The rating reflects EMHS' increasingly centralized management and governance model, which we expect will unify financial and operational efforts across all members, ongoing state-wide expansion efforts including the successful integration of Mercy Health System of Maine (Mercy), and management's forward looking health reform strategies. We believe this positive forward momentum, a strengthening enterprise profile, and improved year to date financial performance, which we expect will continue through 2015, should be sufficient to offset increased risk and financial pressure associated with additional debt plans in 2016. The rating is further anchored by EMHS' geographic dispersion serving the entire state of Maine with its newest affiliate in the state's most populous city, Portland, and its flagship in Bangor anchoring a critical component of the rural health care delivery system serving the northern portion of Maine, which includes 70% of the land mass and 40% of the population in the state.

The rating reflects our assessment of EMHS':

- Leading market share and service essentiality, especially at EMMC in Bangor;
- Geographically diverse and large service area throughout the state of Maine including Bangor, the state's third-largest city, and Portland, the largest;
- Successful incorporation into the system and financial turnaround at Mercy;
- Stable unrestricted reserves and moderate leverage; and
- Margins and debt service coverage (DSC) that are generally in line with rating level medians.

Partially offsetting rating factors include:

- Additional debt plans;
- Uncertain operational and financial effect from pending affiliations, although management's success at Mercy bodes well for future affiliates;
- Equity contribution necessary to finance construction at EMMC and other affiliates, which will likely limit growth of

unrestricted reserves; and
- Continued construction and fill-up risks associated with the EMMC expansion, with the project delayed by three months and $10 million over budget.

Securing the bonds is a mortgage and revenue pledge from the obligated group, which includes the parent (EMHS), EMMC, and Acadia Hospital, a 100 bed behavioral health facility. Our rating is based on our view of EMHS' group credit profile and the obligated group's core status. Accordingly, the long-term rating is at the level of the group credit profile.

EMHS is an integrated health system consisting of eight hospitals; 411-bed regional referral center EMMC and Acadia Hospital, both in Bangor, Mercy in Portland, hospitals in Presque Isle and Waterville, and three critical access hospitals in Blue Hill, Greenville, and Pittsfield. EMHS also provides emergency transport, home care, and long-term care services to the region and employs a large portion of the practicing physicians, especially as recruitment has become more difficult in the rural portions of its service area. EMHS is the second-largest health care system in the state behind MaineHealth, which is located in and around Portland and serves the southern portion of the state.

Outlook

The stable outlook reflects our opinion that EMHS' strong enterprise profile combined with management's strategic health reform efforts provide strength to the rating, which helps offset a relatively stable, although modest, financial profile, which will be pressured by the possible issuance of debt in 2016.

Upside scenario

A higher rating is possible once the initial phase of the EMMC project is successfully opened and occupied. In addition, EMHS--including any new system members--need to routinely post cash flow sufficient to cover debt service of all current and proposed debt by about 3x or better while keeping unrestricted reserves above 100 days' cash on hand. Without a commensurate increase in resources, EMHS' proposed debt plans will likely be a near-term limiting rating factor.

Downside scenario

A negative outlook or downgrade during the two-year period covered by this outlook, while not anticipated, could be possible if EMHS' strategic initiatives do not prove to be financially accretive to the organization. We believe EMHS has sufficient debt capacity at the current rating level to accommodate the proposed additional debt, although a significant decline in unrestricted reserves or DSC closer to 2x could trigger a negative outlook or rating change.

Enterprise Profile

Maine has about 1.3 million residents, and although the population is expected to remain flat, it is aging. Bangor is the third-largest city in the state and is the economic hub of the northern and eastern parts of the state, although the population is still modest at 31,000 and the region has a relatively limited economy with a focus on tourism, the service sector, paper, and agriculture. Portland, with a population of 63,200 is considered the state's deepest economy with health care, financial services, higher education, and retail components. The region also has an active fishing and tourism component due to its harbor and deep water port.

EMHS' primary service area population totals almost 300,000 residents with almost 200,000 more residents in its secondary service area. There is limited competition at most of the system's hospitals with the exception of EMMC, which competes with St. Joseph Hospital in Bangor, and Mercy, which operates in Portland and competes with MaineHealth facilities. EMHS holds a dominant 73% market share of the Bangor service area, a 24% share of the Portland market, and almost a 50% share of its northern Maine service area. Competition to the north of Bangor is extremely limited by the rural nature of the geography with many hospitals eliminating services, decreasing beds, and increasingly approaching EMHS for clinical and system support.

EMHS continues to increase its geographic footprint in the state. After adding a presence in Portland through the acquisition of Mercy, EMHS continues its efforts to increase its state-wide presence. For example, EMHS has signed a member substitution agreement to affiliate with 64-bed Maine Coast Memorial Hospital. In addition to increasing its hospital presence, EMHS has established Beacon Health, a network of hospital, physician, and other providers, which is contracting with insurance companies, corporations, and directly with consumers. Beacon Health also oversees EMHS' Pioneer accountable care organization. With 98,000 covered lives at Beacon Health, EMHS expects the business to grow rapidly through the shift in natural market forces, acquisitions, and affiliations.

EMHS admissions rose in 2014 largely due to a full year of Mercy volume. Year to date through the first quarter of fiscal 2015 ended Dec. 27, 2014, EMHS admissions were flat while outpatient visits were above prior year levels. Together EMMC and Mercy generate about 80% of annual admissions and through the first quarter, admissions at both hospitals combined are approximately 1% behind prior year and budgeted levels. Business continues to shift to outpatient as observation visits increased 10% year to date compared with fiscal 2014's first quarter.

Project

EMMC's project to update various clinical areas including the emergency department and surgery, will also bring EMMC back to its 411 licensed bed capacity but with a 46% increase in private rooms. Phase 1 includes a seven-story patient tower with floors housing 32 private rooms, three additional operating rooms, an eight-bed emergency department observation area, and a new main entrance. Phase 2, which is dependent on meeting certain operating and financial targets set by management, includes finishing shelled portions of the patient tower to accommodate 53 neonatal and critical care beds and a major renovation and expansion of surgical and cardiac services. Management estimates the cost of phase 2 to be $100 million funded by $70 million of debt, $20 million of philanthropy, and $10 million of equity. In addition, EMHS must still contribute its $28 million equity to the phase 1 project. At the completion of the project, over half of EMMC's beds will be private and EMMC will operate its full 411 licensed bed complement, which represents a 47-bed increase from its 364 currently available beds.

Management and governance

EMHS is nearing the end of its transformation to an operating model company. At the parent level, EMHS now controls assets and employs all senior management at the individual member hospitals. In addition, EMHS has centralized human resources, information technology, quality, and various financial functions at the system level, which creates efficiencies, potential cost reductions, facilitates quicker decision making, and increases alignment of the members with system goals and objectives. We view these changes positively and believe they should contribute to an improved financial profile over time.

Table 1

Eastern Maine Healthcare And Subsidiaries Enterprise Statistics			
	--Three months ended Dec. 31--	--Fiscal year ended Sept. 27--	--Fiscal year ended Sept. 28--
	2014	2014	2013
Enterprise Profile			
Inpatient admissions	8,008	32,663	26,341
Equivalent inpatient admissions	19,162	77,877	56,574
Emergency visits	33,404	137,275	117,666
Inpatient surgeries	2,442	9,996	7,939
Outpatient surgeries	5,791	23,506	17,031
Medicare case mix index	1.7898	1.7810	1.7743
FTE employees	9,067	9,016	7,214
Active physicians	904	974	928
Based on net/gross revenues	Net	Net	Net
Medicare %	31.0	32.0	32.0
Medicaid %	13.0	15.0	19.0
Commercial/blues %	50.0	49.0	45.0

Inpatient admissions exclude newborns, psychiatric, rehabiliation admissions.

Financial Profile

With the addition of Mercy, EMHS' total operating revenue was sizable at $1.3 billion in 2014. Furthermore, the addition of Mercy increased the system's revenue dispersion with the flagship, EMMC, responsible for just slightly over half of 2014's revenue. Fiscal year 2014 results were below budget and below expectations set at the time of the last review with slightly better than breakeven results from operations driven by increased uncompensated care due to fewer Medicaid recipients, assimilation of Mercy into the system, and continued investment in organizational transformation. Mercy did post a profit at year end of almost $3.5 million, however half of the system hospitals ended the year with losses.

Management has a performance improvement process in place and expects about $30 million of targeted $100 million in savings will be realized in 2015. Through the first quarter of fiscal 2015, system performance is above prior year and budget with profits at six of the eight hospitals and all but one hospital posting earnings above the comparable first quarter of fiscal 2014. Management expects to outperform its budgeted $14 million operating income by about $6 million in 2015, which should generate over 3x DSC. EMHS benefits from disproportionate share, receiving almost $13 million in 2014. However the benefit is partially offset as EMHS is a payer into the state's provider tax pool. EMHS' payer mix is challenging with a decline in Medicaid to 13% of net patient service revenue partially offset by increased uncompensated care. The decline in Medicaid stems from stricter eligibility standards in the state's Medicaid program and lack of state Medicaid expansion. If Maine Coast joins the system, it will initially be dilutive, although many of the techniques used to turn around Mercy will likely be applicable to Maine Coast. In addition, Maine Coast is relatively small compared with EMHS with $80 million of revenue. Management expects Maine Coast will be profitable again by

2016.

Unrestricted reserves have steadily increased through 2014 although days' cash on hand declined due to dilution from the full year of Mercy's expenses. Reserves are slightly lower at the end of the first quarter of fiscal 2015 and management is using some short-term lines of credit for construction projects, some of which will be repaid with proposed debt next years. EMHS has plans to issue approximately $144 million of additional debt in 2016 mostly for consolidating the three campuses at Mercy into one and for phase 2 of the EMMC project although the debt will also be used for two smaller projects at Blue Hill Memorial Hospital and Aroostook Medical Center. Of the $144 million about half is for the EMMC project with the timing to proceed still uncertain although with the strong year to date performance at EMMC, we expect the project will ultimately be approved. The consolidation of Mercy campuses is expected to save an amount approximately equal to debt service once the consolidation is complete.

Pro forma debt ratios assuming this additional debt, will pressure several balance sheet ratios, however, assuming no material changes in its financial profile, we believe EMHS can accommodate $144 million of additional debt at its current rating level.

EMHS' investment allocation is conservative with over three-quarters of unrestricted reserves invested in cash, cash equivalents, and fixed income. Management indicates that over $350 million of its portfolio could be liquidated daily, which sufficiently offsets any risks associated with the direct purchase obligations used to refund Mercy's debt upon its merger into EMHS. A majority of EMHS' remaining debt is fixed rate. EMHS' defined-benefit pension plan is funded at an above-average level with the fair value of plan assets equal to 81% of the projected benefit obligation at the end of fiscal year 2014 despite a drop in the discount rate EMHS has not yet incorporated the new mortality tables, which may lower the ratio next year. EMHS is party to four floating-to-fixed swaps with a total notional amount of almost $21 million and no collateral posted.

Table 2

Eastern Maine Healthcare Financial Statistics				
	--Three months ended Dec. 31--	**--Fiscal year ended Sept. 27--**	**--Fiscal year ended Sept. 28--**	**Medians for 'BBB' rated health care systems**
	2014	**2014**	**2013**	**2013**
Financial performance				
Net patient revenue ($000s)	321,194	1,238,683	960,633	936,016
Total operating revenue ($000s)	337,772	1,299,303	1,018,618	MNR
Total operating expenses ($000s)	330,234	1,296,010	988,268	MNR
Operating income ($000s)	7,538	3,293	30,350	MNR
Operating margin (%)	2.23	0.25	2.98	3.20
Net non-operating income ($000s)	1,160	7,632	17,967	MNR
Excess income ($000s)	8,698	10,925	48,317	MNR
Excess margin (%)	2.57	0.84	4.66	4.60
Operating EBIDA margin (%)	7.06	4.85	7.84	7.80
EBIDA margin (%)	7.38	5.41	9.44	9.10
Net available for debt service ($000s)	25,015	70,681	97,844	90,827
Maximum annual debt service ($000s)	30,683	30,683	30,683	MNR

Table 2

Eastern Maine Healthcare Financial Statistics (cont.)				
Maximum annual debt service coverage (x)	3.26	2.30	3.19	2.90
Operating lease-adjusted coverage (x)	2.76	1.84	2.54	2.30
Liquidity and financial flexibility				
Unrestricted reserves ($000s)	376,441	397,117	379,727	286,859
Unrestricted days' cash on hand	108.6	116.4	146.5	113.30
Unrestricted reserves/total long-term debt (%)	104.4	109.7	122.0	93.90
Unrestricted reserves/contingent liabilities (%)	N.A.	684.0	1016.0	MNR
Average age of plant (years)	10.0	10.8	11.9	11.50
Capital expenditures/depreciation and amortization (%)	133.7	189.9	191.0	171.30
Debt and liabilities				
Total long-term debt ($000s)	360,456	361,902	311,308	MNR
Long-term debt/capitalization (%)	36.1	36.5	36.8	46.80
Contingent liabilities ($000s)	N.A.	58,059	37,374	MNR
Contingent liabilities/total long-term debt (%)	N.A.	16.0	12.0	MNR
Debt burden (%)	2.26	2.35	2.96	3.20
Defined benefit plan funded status (%)	N.A.	80.59	82.21	78.70
Pro forma ratios				
Unrestricted reserves ($000s)	376,441	N/A	N/A	MNR
Total long-term debt ($000s)	504,456	N/A	N/A	MNR
Unrestricted days' cash on hand	100.55	N/A	N/A	MNR
Unrestricted cash/total long-term debt (%)	69.07	N/A	N/A	MNR
Long-term debt/capitalization (%)	44.17	N/A	N/A	MNR

N/A--not applicable. N.A.--not available. MNR--median not reported. Figures include Mercy Health System which was acquired in October, 2013 Pro forma debt includes $144 million possible additional debt in fiscal year 2016.

Related Criteria And Research

Related Criteria

- USPF Criteria: Not-For-Profit Health Care, June 14, 2007
- USPF Criteria: Contingent Liquidity Risks, March 5, 2012
- General Criteria: Methodology: Industry Risk, Nov. 20, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013

Related Research

- Glossary: Not-For-Profit Health Care Ratios, Oct. 26, 2011
- The Outlook For U.S. Not-For-Profit Health Care Providers Is Negative From Increasing Pressures, Dec. 10, 2013
- U.S. Not-For-Profit Health Care System Ratios: Operating Performance Weakened In 2013, Aug. 13, 2014
- Health Care Providers And Insurers Pursue Value Initiatives Despite Reform Uncertainties, May 9, 2013
- 208. U.S. Not-For-Profit Small Hospitals Turn In Mixed 2012 Median Performance Ratios As The Industry Grapples With Change, Oct. 23, 2013
- Alternative Financing: Disclosure Is Critical To Credit Analysis In Public Finance, Feb. 18, 2014

- Health Care Organizations See Integration And Greater Transparency As Prescriptions For Success, May 19, 2014