US Public Finance

Weekly Credit Outlook

OCTOBER 25, 2012

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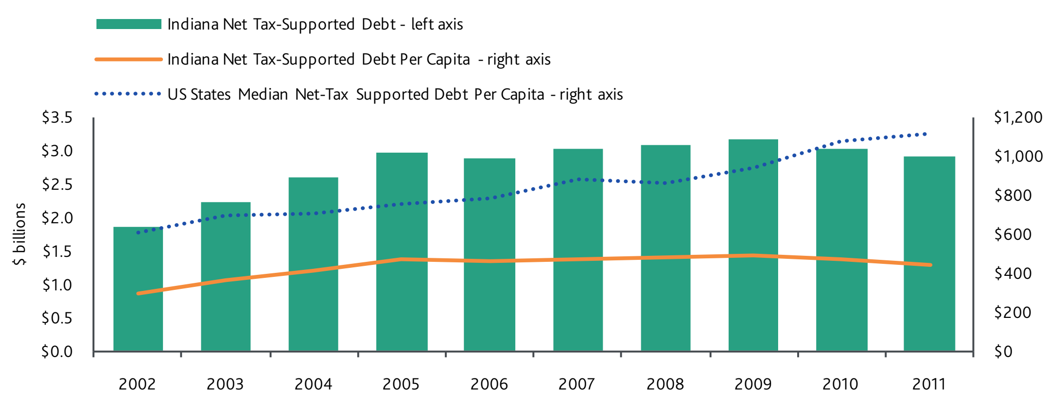
Indiana Uses Budget Surplus to Reduce Outstanding Debt by 5%

On October 17, Indiana Governor Mitch Daniels announced that Indiana (Aaa stable) will use budget surplus funds to defease $147 million of outstanding debt in mid-November. The defeasance will reduce the state's outstanding net tax-supported debt, which is already among the lowest of the 50 states, by 5%, a credit positive.

The defeasance, which the state expects to complete by the end of November, affects 13 series of lease appropriation bonds that were issued to finance 10 government facilities. The action will further reduce Indiana's already low debt burden, which was $2.9 billion, as shown on the left axis in Exhibit 1 below. Based on our 2012 State Debt Medians Report, Indiana's net tax-supported debt per capita ranks 42nd at $446, is well below the US median of $1,117, and its debt to personal income of 1.3% also ranks 42nd compared to the US median of 2.8%. The state's debt ratio (debt service divided by operating and other pledged revenues) was 2.0% in fiscal 2011, a decrease from 2.2% in the prior year, and is the eighth lowest among American states.

EXHIBIT 1
Indiana's Debt Is Low Compared to Most States

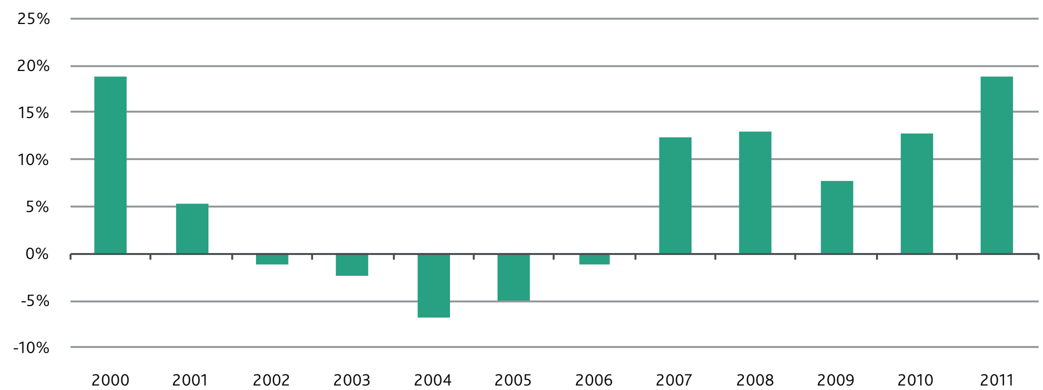


Source: Moody's

The defeasance will eliminate $34 million of annual debt service payments that would otherwise be appropriated in the fiscal 2014-15 biennium, improving fiscal flexibility. Indiana's fiscal flexibility is already strong, with an available fund balance of $2.4 billion or 18.8% of revenues in fiscal 2011. According to the state, it ended fiscal 2012 with reserves of $2.2 billion (unaudited) and based on current estimates it expects to end fiscal 2013 (ending June 30) with $2.0 billion, which is noteworthy because as recently as fiscal 2006 the state's fund balance was negative (see Exhibit 2).

EXHIBIT 2

Indiana Available Fund Balance as a Percentage of Operating Revenue



Source: Moody's

Indiana has returned to fiscal health more quickly than most states. Through expenditure restraint and conservative revenue projections, the state achieved a structural surplus of $572 million in fiscal 2012 (unaudited) and expects a structural surplus of $425 million in fiscal 2013.

In addition to debt reduction, the state has undertaken various measures to reduce expenditures related to pension plans. For example, in 2011 it enacted a law that automatically shifts a portion of reserves in excess of 10% of budgeted appropriation toward increasing contributions to various state pension funds. Additionally, through benefit reform and contributions in excess of the actuarially determined requirement, Indiana's other post-employment benefit liability was reduced from $524.9 million in fiscal 2010 to $383.2 million in fiscal 2011 and has been reduced a further 17% in fiscal 2012.

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Proposed Health Systems' Mega Merger Is Positive for the Not-for-Profit Healthcare Sector

Last week, two of the largest not-for-profit healthcare systems in the US, Trinity Health (Aa2 stable) and Catholic Health East (A2 stable), signed a non-binding letter of intent for a proposed merger, with a definitive agreement to be executed by Spring 2013.

The proposed merger between these two Catholic systems is emblematic of the increased consolidation activity presently occurring in the US not-for-profit hospital industry. Announcements of hospital mergers, acquisitions, joint operating agreements and other types of consolidation are happening on a near weekly basis as hospital providers pursue scale with other partners. We view consolidation as a credit positive for the industry overall as merger, acquisitions and various partnership models should create greater efficiencies and lead to reduced hospital operating costs over the long term. Consolidation is one of the positive mitigants to our negative sector outlook for the not for profit hospital industry[1].

What makes the Trinity-Catholic Health East announcement particularly noteworthy is the size and national geographic presence of these two individual healthcare systems.

TRINITY AND CATHOLIC HEALTH EAST REPRESENT THE FIRST MULTISTATE SYSTEM-TO-SYSTEM MERGER IN NEW WAVE OF CONSOLIDATION

Within the Moody's-rated portfolio of the 16 multistate healthcare systems, Trinity is fifth largest with $8.4 billion in annual revenues while Catholic Health East is the eighth largest multistate system with $4.3 billion in revenues[2] (see Exhibit 1). The combined entity would catapult to be the second largest Moody's-rated not-for-profit multistate hospital system in the US with $12.8 billion in revenues after Ascension Health with $15.5 billion. Providence Health System (rated Aa2) merged with Swedish Health System earlier this year to combine for $10.7 billion in revenues. However, Swedish was not a multistate system as its facilities are only located in Seattle and surrounding service area. Prior to the merger, Swedish had $2.0 billion in revenues.

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1 See Not-for-Profit Healthcare Mid-Year 2012 Outlook: Strong Headwinds Continue, September 2012
2 Based on FY 2012 and FY 2011 audits, respectively.

EXHIBIT 1

Merger of Trinity and Catholic Health East Catapult New Enterprise to Second Largest Multistate System

	Multistate Healthcare System by Revenue	Rating	Outlook	Operating Revenue ($'000)	Direct Debt ($'000)
1	Ascension Health, MO	Aa1	Negative	15,512,816	4,232,275
2	Dignity Health, CA	A3	Stable	9,854,668	4,238,198
3	Catholic Health Initiatives, CO	Aa3	Stable	8,940,980	4,694,216
4	Providence Health & Services, WA*	Aa2	Negative	8,739,181	2,297,755
5	**Trinity Health Credit Group, MI**	**Aa2**	**Stable**	**8,456,153**	**3,362,452**
6	Adventist Health System/Sunbelt Obligated Group, FL	Aa3	Positive	7,246,450	3,225,365
7	IHC Health Services, Inc., UT	Aa1	Stable	4,693,600	1,346,300
8	**Catholic Health East, PA**	**A2**	**Stable**	**4,341,450**	**1,627,438**
9	Sisters of Mercy Health System, MO	Aa3	Stable	4,264,228	815,940
10	St. Joseph Health System, CA	A1	Stable	4,250,650	1,665,829
11	Catholic Health Partners, OH	A1	Positive	3,798,806	1,768,218
12	CHRISTUS Health, TX	A1	Stable	3,792,159	1,172,961
13	Bon Secours Health System, Inc., MD	A3	Stable	3,278,875	1,062,409
14	Sisters of Charity of Leavenworth Health System, KS	Aa3	Stable	2,685,400	1,424,500
15	Franciscan Alliance (f.k.a. Sisters of St. Francis Health Services, Inc.), IN	Aa3	Stable	2,458,748	1,141,014
16	Hospital Sisters Services, Inc., IL	A1	Stable	1,991,424	550,924

*Does not reflect February 1, 2012 merger with Swedish Health System ($2.0 billion in revenues)

Source: Moody's, health care systems' audited financial statements for FY 2011 or FY 2012 (bad debt reflected as revenue deduction for FY 2012)

We expect more system-to-system mergers to be announced given the need to drive up operating efficiencies through scale and leverage. Please see our special comment, "New Forces Driving Rise in Hospital Consolidation" (March 2012) for the factors behind today's consolidation wave.

We first witnessed large system-to-system mergers in the late 1990s and early 2000s, the first wave of hospital consolidations. Many of the larger multi-state systems were the result of regional mergers. Trinity was created in 2000 with the merger of two large regional Catholic systems (Holy Cross Health System and Mercy Health System) while Catholic Health East was the result of the 1998 merger of three systems—Allegany Health System, Eastern Mercy Health System and Sisters of Providence Health System. Wednesday's announcement is the first proposed multistate system-to-system merger since the mid 1990s.

CREDIT IMPLICATIONS MIXED FOR TRINITY HEALTH AND CATHOLIC HEALTH EAST

In the short-term, should the two systems combine their operations and debt obligations, the proposed merger is credit positive for Catholic Health East but credit negative for Trinity Health. The bifurcation is based on resulting changes to each systems' financial and debt coverage metrics and the expected timing of improvements in these metrics (see Exhibit 2). Both organizations have been through mergers and other consolidation strategies in the past which could alleviate the negative impact on Trinity and strengthen the combined entity. Effective governance and leadership, financial planning and strong operating execution are integral strategies for successful large scale mergers. Likewise, the speed at which the combined organization garners savings and the durability of the savings, particularly over the large continental service area, will be a key factor in any rating action pertaining to Trinity Health and Catholic Health East. However, there is little geographic overlap between Trinity (located primarily in the mid-west) and Catholic Health East (facilities along the eastern seaboard), which will limit large upside savings of clinical consolidation. Nonetheless, we expect material savings over the longer term as the enterprises leverage their skill and scale.

EXHIBIT 2

Key Indicators for Trinity Health and Catholic Health East

	Trinity Health	Catholic Health East	Combined
Long-term Rating	Aa2	A2	
Total Revenues	$8,456,153	$4,341,000	$12,797,153
Unrestricted Cash and Investments	$4,745,788	$1,725,000	$6,470,788
Total Long-Term and Short-Term Debt	$3,362,452	$ 1,600,000	$4,962,452
Cash to Debt	141.1%	107.8%	130.4%
Debt to Revenue	39.8%	36.9%	38.8%

Source: Trinity Health FY 2012 Audited Financial Statements ending June 30, 2012; Catholic Health East FY 2011 Audited Financial Statements ending December 31, 2011

RESEARCH HIGHLIGHTS

Speculative-grade US Local Government Sector: Still Small but Growing

As regional economies recover slowly, additional local governments will likely see their credit quality descend into the speculative grade territory, although speculative-grade issuers will continue to make up a very small portion of the close to 8,000 cities, counties and school districts that we rate. We currently assign speculative ratings to 30 issuers that have approximately $10 billion in aggregate debt. During the past year, we downgraded 10 issuers into speculative grade while we also upgraded four local government issuers into investment grade.

California School Districts Face Mounting Credit Pressure If Tax Initiative Fails in November Election

If California voters reject Propositions 30 and 38, which are the two tax initiatives for school funding on the November ballet, school districts would be subjected to mandated trigger cuts in state funding. As a result, we would place school districts with weak liquidity on downgrade review soon after the election. We would expect as many as 150 of the 327 California school districts that we rate to face some degree of fiscal pressure if both propositions are defeated.

Moody's Framework for Monitoring US Public Finance Ratings

We outline the various processes and tools we use to monitor ratings on approximately 15,900 unique public finance obligors. In addition to the full analyst reviews we perform on every new rating that we assign, we leverage quantitative and qualitative tools in multiple steps to identify credits that have material changes in their financial, economic or demographic situation. Each step of the surveillance process entails a higher degree of analyst scrutiny to identify ratings that may require a rating or outlook change. We communicate the results of rating reviews that proceed to full committees in rating-specific reports and press releases.

US Municipal and Public Power Utilities: Household Electric Utility Affordability - Impact of Recession and Outlook

Despite the contraction in real household incomes in recent years, residential electricity and natural gas have remained affordable. But increased amounts of government transfer payments have been supplementing household incomes. The potential reduction of these payments is a risk to the affordability of these utilities for some households. Other downside risks for affordability include heightened regulatory compliance costs and unexpected increases in natural gas prices.

US Not-For-Profit Healthcare Quarterly Ratings: Driven by M&A Activity, Upgrades Surpass Downgrades in Third Quarter 2012

The $3.2 billion of upgraded debt of the not-for-profit healthcare sector in the third quarter far surpassed the dollar amount of downgraded debt, $957.3 million, for a ratio of 3.3 to 1. The number of upgrades, 12, also surpassed the number of downgrades, 7, for a ratio of 1.7 to 1. The predominance of upgrades reflected an increase in merger and acquisition activity in the sector and not a fundamental change in its underlying credit conditions, which remain negative. Half of the third-quarter upgrades were a result of consolidations or favorable lease agreements.

[US Public Infrastructure: Slow Economic Recovery Tests Willingness to Manage Rates and Costs]

Several infrastructure sectors, such as airports and ports, have witnessed rating downgrades because of weak economic conditions and a lack of willingness among some issuers to maintain their financial profile through the economic cycle. From a credit perspective, however, we expect issuers to continue to avail themselves of their rate-setting and cost-cutting flexibility to maintain a financial profile appropriate for their rating category.

[US Airport Medians for FY 2011]

The medians for fiscal year 2011 highlight some key trends in the US airport sector. From the medians, we see that enplanements were slightly positive, growing 1.1% with the most positive growth occurring early in the year. Airline concentration was level, but hub airports saw strong growth in connecting traffic reflecting the industry trend of reinforcing hub activity and limiting point-to-point travel between smaller markets. Leverage generally declined, leading to higher debt service coverage ratios.

RATING CHANGES

Nassau County (NY): G.O. Rating Downgraded to A2, Outlook Stable

Oct. 23 – We downgraded to A2 from A1 the rating on Nassau County's (NY) $1.4 billion in general obligation debt, revising the outlook to stable from negative. The downgrade reflects further weakening of the county's financial position in fiscal 2011 and the expectation that fund balance will continue to decline in fiscal 2012. The rating incorporates the county's significantly reduced liquidity, weak governance practices, and significant exposure to variable rate debt and interest rate swaps. Positive factors supporting the A2 rating include the oversight of the county's finances provided by the Nassau County Interim Finance Authority, which moved to a hard control board on January 26, 2011, a large and wealthy tax base, and a manageable debt position.

Children's Hospital Colorado's Outlook Revised to Stable from Positive, A1 Rating Affirmed

Oct. 22 – The hospital is launching several additional projects, which will entail significant additional capital costs, and the possibility of a sizable bond offering in 2013, leading us to change its outlook to stable from positive. The affirmation of the A1 rating is based on Children's Hospital Colorado's strong balance sheet and profitability, its growing market share in the Denver region, and its successful completion of a sizable addition.

Cherokee County School System (GA): Downgraded to Aa2 from Aa1; Outlook Stays Negative

Oct. 23 – The downgrade to Aa2 from Aa1, affecting $371 million in general obligation debt, reflects the school system's weakened reserve position and limited liquidity, which has driven the need for cash flow borrowing in recent years. The rating also incorporates the system's primarily residential economy that has been experiencing significant declines over the past four years, pushing the district's operational tax rate near the limit. The rating takes into consideration the system's above-average debt burden, which we expect to increase given recent voter approval for additional borrowing. The outlook on the bonds is negative.

South Florida Water Management District's COPs Downgraded to Aa3 from Aa2

Oct. 23 – We have downgraded the rating on South Florida Water Management District's $489.6 million outstanding Certificates of Indebtedness (COPs) because of the district's diminished autonomy and the reduced level of district revenues, primarily property taxes, available to repay debt service on the COPs. The outlook is stable.

Berkeley County School District (SC): G.O. Bonds Upgraded to Aa2 from Aa3

Oct. 19 – We upgraded our underlying rating on the district's $151 million of general obligation debt to Aa2 because of the district's sizable, albeit concentrated, tax base that continues to benefit from its proximity to Charleston and historically sound level of reserves bolstered by its formal reserve policies and conservative budgeting practices. Concurrently, we assigned the Aa2 rating to $45 million of bonds expected to be issued on Oct. 25 and upgraded to Aa3 from A1 the rating on $296 million of installment purchase revenue bonds.

MultiCare Health System (WA): Outlook to Positive, A1 Rating Affirmed

Oct. 18 – The change in outlook to positive from stable and the affirmation of MultiCare Health System's (MHS) A1 rating reflect the continuation of strong operating measures despite challenges in the state of Washington, and good patient volume and continuing revenue growth. Certain fundamental challenges of the organization remain, including a relatively large debt balance, significant competition in its primary service area, and ongoing challenging demographics. Furthermore, the $60 million of additional debt increases MultiCare's already significant debt load by 18%. MHS has approximately $913 million of rated debt.

Highline School District No. 401 (King County) WA: G.O. Bonds Downgraded to Aa3 from Aa2

Oct. 17 – We assigned a Aa3 underlying rating to $64 million of new general obligation debt, lowered the rating on all the school district's $293.3 million in debt to Aa3 from Aa2, and changed the outlook to stable from negative. The downgrade primarily reflects the district's weak financial performance relative to Aa2 rated issuers. The rating continues to incorporate the district's large tax base, average socioeconomic indicators, and moderate debt burden. The stable outlook reflects our view that the district's general fund reserve levels will remain chronically low relative to its rated peers over the short-to-medium term but its financial operations will not significantly deviate from recent trends.

City of Worcester (MA): Upgraded to Aa3 from A1

Oct. 17 – Affecting approximately $637.5 million in debt, including $72.1 million in new bonds, we upgraded the City of Worcester's (MA) general obligation rating to Aa3 from A1 to reflect the city's improved overall credit profile. Management has demonstrated a commitment to improving the city's financial operations through a five-point plan that has enhanced long-term operating stability. The Aa3 rating and stable outlook also reflect an improving reserve position, moderate tax levy capacity under Proposition 2½, and the city's efforts to address significant unfunded liabilities for pension and OPEB. The city also has a sizeable tax base anchored by multiple health and higher education institutions and strong redevelopment potential, and an above-average debt position that is expected to remain elevated for the medium term.

Catholic Health Initiatives (CO) Downgraded to Aa3, Outlook Stable

Oct. 17 – We assigned an Aa3 rating to Catholic Health Initiatives' (CHI) $1.5 billion of Series 2012 taxable fixed rate revenue bonds and downgraded the long-term rating to Aa3 and Aa3/VMIG1 from Aa2 and Aa2/VMIG1 on all its bonds. The rating downgrade is attributable to a sizable 32% increase in direct debt. Multiple strategic initiatives will occupy management and demand careful oversight, including acquisitions, divestitures, new joint operating agreements, along with expansion of information technology and continued focus on the revenue cycle and expense controls. Contributing to the stable outlook is CHI's strong geographic diversification across 19 states and 74 acute care hospitals with a mixture of urban and rural hospitals that diversifies cash flow sources.

Downgrades of Natixis and Credit Agricole Lead to Downgrades of 20 Local Housing Finance Agency Transactions

Oct. 17 – We downgraded the ratings of 20 local housing finance agency deals totaling approximately $151 million to Aa1 from Aaa after the recent downgrades of Natixis and Credit Agricole to A2/P-1 from Aa3/P-1, which provide the guaranteed investment contracts for these transactions. We had previously downgraded eight local housing authorizes for the same reason on September 24 and downgraded six additional ones also on October 17.

MOODY'S MUNICIPAL BOND YIELD AVERAGES (%)*

Yields (%)						Past 12 Months		Monthly Average **	
	10/18/2012	10/11/2012	10/4/2012	9/27/2012	9/20/2012	High	Low	September	August
20-Year									
Composite	3.50	3.56	3.46	3.58	3.62	4.57	3.58	3.58	3.69
Aaa	2.88	2.94	2.84	2.95	2.99	3.91	2.96	2.96	3.00
Aa	3.11	3.17	3.07	3.19	3.23	4.20	3.19	3.19	3.25
A	3.61	3.67	3.56	3.67	3.72	4.80	3.68	3.68	3.81
Baa	4.40	4.46	4.37	4.49	4.53	5.58	4.49	4.49	4.71
10-Year									
Aaa	1.76	1.81	1.86	1.97	2.06	2.63	1.93	1.98	1.93
Aa	2.00	2.05	2.08	2.20	2.30	2.90	2.17	2.22	2.17
VMIG	0.21	0.19	0.18	0.18	0.17	0.23	0.08	0.17	0.14

* Moody's Municipal Bond Yield Averages have been published weekly since 1937. They are derived from pricing data on unenhanced newly issued general obligation bonds. Each observation is an unweighted average, with the Composite average representing the unweighted average of the corresponding 20-Year observations. Highs and lows refer to monthly averages.

** Average of weekly observations.

FULLY SUPPORTED MUNICIPAL AND IRB DEALS

RATINGS ASSIGNED

October 18

Wells Fargo Stage Trust (Muni. Deriv.) FR Certificates

$ 85.93MM Ser. 2012-83C FR due 2034...Aa2/VMIG 1

(Wells Fargo Bank, N.A./ Liquidity Facility)

Eclipse Funding Trust, (Muni. Deriv.) Custodial Receipts

$ 20.57MM 5.00% Ser. 2012-0003B CR due 2042...Aa2

(U.S. Bank National Association/ Letter of Credit - Direct Pay)

October 19

RBC Municipal Products Inc. (Muni. Deriv.) FR Certificates

$ 30.00MM Ser. E-38 FR due 2044...Aa3/VMIG 1

(Royal Bank of Canada/ Liquidity Facility)

RBC Municipal Products Inc. (Muni. Deriv.) Custody Reciepts

$ 30.00MM Ser. 2012-E38 CR due 2044...Aa3

(Royal Bank of Canada/ Letter of Credit - Direct Pay)

October 22

Illinois Housing Development Authority, Multifamily Housing Revenue Bonds

$ 8.00MM Ser. 20120 .75% due 2014...Aaa

(United States of America, Government of/ Reinvestment Account)

October 23

Utah Housing Corporation, Mortgage Revenue Bonds

$ 14.52MM 3.40% Ser. 2012 due 2030...Aaa

(Federal Home Loan Mortgage Corp./ Credit Enhancement Agreement)

Utah Housing Corporation, Mortgage Revenue Bonds

$ 0.20MM 1.30% Ser. 2012 due 2017...Aaa

(Federal Home Loan Mortgage Corp./ Credit Enhancement Agreement)

Utah Housing Corporation, Mortgage Revenue Bonds

$ 0.21MM 1.60% Ser. 2012 due 2018...Aaa

(Federal Home Loan Mortgage Corp./ Credit Enhancement Agreement)

Utah Housing Corporation, Mortgage Revenue Bonds

$ 0.22MM 1.85% Ser. 2012 due 2019…Aaa

(Federal Home Loan Mortgage Corp./ Credit Enhancement Agreement)

Utah Housing Corporation, Mortgage Revenue Bonds

$ 0.23MM 2.15% Ser. 2012 due 2020…Aaa

(Federal Home Loan Mortgage Corp./ Credit Enhancement Agreement)

Utah Housing Corporation, Mortgage Revenue Bonds

$ 0.25MM 2.40% Ser. 2012 due 2021…Aaa

(Federal Home Loan Mortgage Corp./ Credit Enhancement Agreement)

Utah Housing Corporation, Mortgage Revenue Bonds

$ 0.25MM 2.70% Ser. 2012 due 2022…Aaa

(Federal Home Loan Mortgage Corp./ Credit Enhancement Agreement)

Utah Housing Corporation, Mortgage Revenue Bonds

$ 1.16MM 3.10% Ser. 2012 due 2026…Aaa

(Federal Home Loan Mortgage Corp./ Credit Enhancement Agreement)

October 24

RBC Municipal Products Inc. (Muni. Deriv.) FR Certificates

$ 149.99MM Ser. E-41 FR due 2018…Aa3/VMIG 1

(Royal Bank of Canada/ Letter of Credit - Direct Pay)

Eclipse Funding Trust, (Muni. Deriv.) Custodial Receipts

$ 25.00MM 4.00% Ser. 2012-0013 CR due 2031…Aa2

(U.S. Bank National Association/ Letter of Credit - Direct Pay)

Wells Fargo Stage Trust (Muni. Deriv.) Custody Receipts

$ 7.34MM 3.00% Ser. 2012-CR-86C-2 due 2030…Aa3

(Wells Fargo Bank, N.A./ Swap Agreement)

Wells Fargo Stage Trust (Muni. Deriv.) Custody Receipts

$ 7.55MM 3.00% Ser. 2012-CR-86C-3 due 2031…Aa3

(Wells Fargo Bank, N.A./ Swap Agreement)

New York State Housing Finance Agency, Housing Revenue Bonds

$ 40.00MM Ser. 2012 A-1 due 2046...A2/VMIG 1

(Manufacturers and Traders Trust Company/ Letter of Credit - Direct Pay)

New York State Housing Finance Agency, Housing Revenue Bonds

$ 20.00MM Ser. 2012 A-2 due 2046...A2/VMIG 1

(Manufacturers and Traders Trust Company/ Letter of Credit - Direct Pay)