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New York State Dormitory Authority Mount Sinai Hospital Obligated Group; System

Primary Credit Analyst:
Martin D Arrick, New York (1) 212-438-7963; martin.arrick@standardandpoors.com

Secondary Contact:
Stephen Infranco, New York (1) 212-438-2025; stephen.infranco@standardandpoors.com

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Long Term Rating	A-/Negative	Outlook Revised

Rationale

Standard & Poor's Ratings Services revised its outlook to negative from stable and affirmed its 'A-' long-term rating on the New York State Dormitory Authority's $293.2 million series 2010A bonds and $62.5 million series 2011A bonds, issued for Mount Sinai Hospital Obligated Group (MSH)--which includes its flagship Mount Sinai Hospital on Manhattan's Upper East Side, as well as a campus in the New York City borough of Queens.

MSH is the only obligated entity within the larger Mount Sinai Hospitals Group, which is comprised of seven hospital campuses in New York City including the Beth Israel Medical Center (BI), which in turn includes Beth Israel Brooklyn, St. Luke's-Roosevelt Hospital Center (SLR) and The New York Eye and Ear Infirmary (NYEEI).

The rating incorporates the 2013 transaction which created a new entity (Mount Sinai Hospitals Group Inc.) that was formed to become the parent of MSH and the hospitals that were previously part of Continuum Health System: BI, SLR and NYEEI. Another entity—-Mount Sinai Health System, Inc.—-was formed to become the parent of Icahn School of Medicine at Mount Sinai (ISMMS) and The Mount Sinai Medical Center Inc. (MSMC) and Mount Sinai Hospitals Group, Inc. The Mount Sinai Medical Center, MSH and ISMMS are the members of three real estate companies that are a material part of the Health System.

The rating and negative outlook reflects the continued financial strength of MSH as the flagship for the Mount Sinai Hospitals Group, strong fund raising for the entire system, and an improved and very strong enterprise profile of the system as a whole, which was improved by the 2013 transaction with Continuum. The Hospitals Group has what we view as an excellent business position in densely populated Manhattan and an enlarged and favorable profile throughout New York City that positions it well generally, and, more specifically for health reform and population health management initiatives. It retains a large patient draw from many of New York's suburbs as well, given MSH's strong tertiary capabilities and national reputation.

The negative outlook reflects sharply depressed financial performance for the Mount Sinai Hospitals Group in 2014—-the first full year since the merger—-due, in large part, to the drop in volume, BI's performance in particular, and numerous medical staff departures. At the same time, in response to these and other issues, the senior management team of the Hospitals Group made a series of management changes at the local hospitals, including new chief executives, changes to many of the direct reports to the local chief executives, as well as changes in the physician leadership at the medical departmental level and the recruitment of many new physicians.

While performance of the flagship MSH has been maintained, performance at BI has been particularly weak. During this time, overall volume has dropped and financial performance for the hospitals group as a whole has suffered directly leading to the negative outlook. While management anticipated a decline in performance in 2014, it did not expect it to be as large as experienced. However, management believes that new physician leadership and facilities management teams, on-going physician recruitment and significant additional state funding for new models of care will lead to financial improvement going forward. We expect this financial improvement to take time as senior management moves to a 'centers of excellence' integrated model and not a 'hub and spoke' model and the benefit of many of the new physician practices and other changes begin to mature. Failure to significantly improve performance as forecast for fiscal 2016 will result in a lower rating, although clear signs of improvement over the interim period, even if slow and steady, need to be demonstrated to return to a stable outlook.

In addition to MSH and the Mount Sinai Hospitals group, a larger family of companies constitutes the Mount Sinai Health System Inc. including ISMMS, the MSMC, and a number of real estate subsidiaries. All of the entities are closely knit and have overlapping senior management and boards, but each remains obligated on its own debt and as a result no consolidating financial audits are available, although management has provided a comprehensive unaudited system consolidation.

The rating affirmation reflects our view of Mount Sinai Hospital Group's:

- Solid business position centered around MSH as one of the country's premier academic medical centers located in Manhattan, a large faculty practice plan and physician network, and excellent locations with campuses throughout Manhattan as well as a presence in Queens and Brooklyn as well;
- Meaningful scale with total hospital group revenues of $4.8 billion for 2014, a base of 138,000 inpatient admissions and considerable opportunities for improved operations, service line consolidation and cost saving synergies;
- Adequate excess income and cash flow for the rating despite operating losses in 2014, generating maximum annual debt service (MADS) coverage of 2.9x;
- Adequate liquidity for the rating with $1.4 billion in unrestricted cash and investments as of Dec. 31, 2014, equal to a solid 120% of debt, but just 116 days' cash, augmented by historically strong fundraising; and
- Stable and experienced senior management team that has been together for many years, including the dean of the medical school, providing stability and continuity to strategic and financial planning and positive momentum to the hospitals group and the entire Mount Sinai Health System including numerous population health management initiatives.

Management has laid out a forecast and vision for the future that shows a gradual recovery beginning in earnest in 2016 while the various hospitals and physicians form a more cohesive system. Significant revenue growth and cost savings opportunities have been identified and should be more apparent as new leadership teams at the facilities and medical department level become acclimated. The hospital group will also benefit from an estimated $150 million over the next three to five years from special governmental funding sources, in particular the Delivery System Reform Incentive Program as well as the Vital Access Provider program.

Other factors that support the rating include the benefits of having a fully integrated medical school including a solid and growing research presence, system wide platform for medical trials, sound royalty revenues, academic appointments at ISMMS for physicians from all of the hospitals, and high nationwide rankings from third parties for both MSH and the ICMMS. In addition, the school has a strong faculty practice plan, excellent physician recruiting success including at the acquired hospitals over the past 18 months, and very strong fundraising capability and growing research funding. Financial strength for the entire Mount Sinai Health System is augmented by permanently restricted funds (largely endowment) totaling $578 million, and temporarily restricted resources of $460 million, tempering the modest days' cash on hand calculation.

A gross receipts pledge and a mortgage on MSH secure the bonds. The obligated group consists of Mount Sinai Hospital, which includes two hospitals operating under one license in Manhattan and Queens, N.Y. All of MSH's direct bonds are fixed rate, while a small $21.3 million accounts receivable financing is variable rate. There is a $143.7 million variable-rate bond issue secured by a letter of credit (LOC) for the residential tower, guaranteed by the hospital, although the tower is fully leased and self-supporting. In addition, MSH entered into a $112 million fixed rate direct purchase deal in late 2013 to fund a long-anticipated renovation of MSH's Queens Division. The direct purchase series 2013A and 2013B are secured by supplements to the master trust indenture. Financial covenants, which are comparable with rated bond issues, include a 30 days' cash requirement and long-term debt service coverage of 1.25x. In the event of a default, remedies include immediate payment after notice to the trustee. In our opinion, MSH maintains sufficient liquidity to manage this contingent exposure based on MSH's overall investment portfolio. MSH is not a party to any swaps, although SLR and Beth Israel entered into two variable to fixed rate swaps with a total notional amount of $156.4 million.

The rating also reflects our assessment of the credit strength of the Hospitals Group as whole, MSH's role as a core entity within the Hospitals Group, which is managed by unified management team, and separate but fully overlapping boards that effectively function as a single unit, and the very close connection with the 'A-' rated ISMMS. The entire system benefits from integrated management; substantial board overlap; combined strategic planning, fundraising, investment pooling; intertwined physical facilities; and substantial intercompany financial transactions. Under our criteria Mount Sinai Hospital Group is considered a system and given MSH is a core member of the system, it is evaluated using our system criteria.

Financial reporting for the various Mount Sinai entities remains fragmented: Each entity is audited separately; with no system wide audit available despite what we believe is substantial intercompany activity throughout much of the organization. Given the high level of interconnected governance and management, transparency regarding the combination of the entities is limited although management provides more detailed consolidating schedules. We based the aforementioned figures on unaudited management consolidations for the Hospitals Group and the entire system.

Outlook

The negative outlook reflects our belief that the new Mount Sinai Hospitals Group is facing significant transition issues as MSH absorbs the former Continuum facilities into its structure. Overall the improved enterprise profile of the large hospitals group and the system as a whole is offset by weak financial results in 2014. If overall financial performance does not begin to show meaningful improvement either through improved operations in 2015 or a clear path to improved operations in 2016, a downgrade to 'BBB+' is likely. Over the two-year outlook period a revision to a stable outlook would be based on MADS coverage improving to at least 3x MADS and combined with a stable balance sheet.

Enterprise Profile

The Mount Sinai Hospitals Group has a strong 14% market share of adult medical/surgical inpatient admissions within New York City. Within Manhattan the Hospitals Group has an overall market share of adult medical/surgical inpatient volume that is very strong at 39%, followed by a 12% share in Brooklyn and a 10% share in Queens. Overall inpatient admissions have declined 6.5% in 2014 to 138,181 from 147,787 in 2013 due in part to a sharp rise in observation cases, general city-wide trends, and the significant turnover in medical staff. However, the comparable figures for 2013 included the nine month period before the former Continuum facilities became part of the Hospitals Group. Management projects that volume will be relatively stable in 2015 and will begin to increase in 2016 as the many changes that have been initiated, including new physician recruitments, settle in. In addition, the Hospitals Group participates in HealthFirst, which is a Medicare and Medicaid managed care health plan. The hospital group current manages roughly 150,000 covered HealthFirst lives and with total related revenue under management of roughly $780 million. In addition, the Mount Sinai Hospitals Group participates in shared savings agreements with other insurers totaling another 84,000 lives.

In 2013, MSH did a direct purchase issue to fund the expansion and modernization of MSH's Queens Division. MSH estimates the project will cost about $125 million. Queens is an important market for MSH because many referrals to the Manhattan campus come from Queens. The Queens project includes construction of large ambulatory care building and an expanded emergency department and expanded operating rooms. The first phase of the project including the renovated emergency room should go on line in late 2015 with the ambulatory building opening in mid-2016. The outpatient component of this project is consistent with management's broader strategy of constructing large outpatient centers across the region including a 75,000-square-foot facility in Brooklyn in 2013. Management is also aligning with other community hospitals and regional medical groups as well on a national scale where appropriate. For example MSH has developed a relationship with National Jewish Health–-a nationally recognized respiratory specialty hospital based in Denver, Colo.

There are a total of three material real estate entities that are incorporated into our analysis of the Mount Sinai Health System. These include MSMC Realty Corp., MSMC Residential Realty LLC, and 8 East 102nd Street LLC. These companies are owned by MSH, ISMMS, and MSMC in varying degrees. These companies have aggregate outstanding debt of $289 million. This debt is largely for real estate projects and is factored in our analysis, although it is self-supporting. The real estate includes many apartments rented by employees and buildings that house an apartment tower, medical school space as well as hospital space. The physical facilities are highly intertwined and the parties lease substantial space from each other, all of which are eliminated in management's financial compilation. The LOC supporting the financing of the residential tower is guaranteed by MSH, and has been built on top of space being used by ISMMS. We included these debt instruments in both the hospital and medical school analysis.

Management and governance

A board of trustees governs the Mount Sinai Hospitals Group and each of the subsidiary entities including MSH and the three other hospital companies. The boards of MSH, BI, and SLR are identical to each other and were initially composed of 25 members from the original Mount Sinai board and 20 from the Continuum board. The board of NYEEI is generally comparable but also includes physicians on the medical staff of that institution. The 45 trustees of the MSH, BI, and SLR boards will also be the members of the Board of the Hospitals Group upon completion of the New York State Health Departments trustee review process. The parent Mount Sinai Health System board is smaller, and its initial membership included 12 members from Mount Sinai and eight from Continuum. While the initial boards were representative of the founding systems, future board appointments will not be based on original alignment. Management reports the board is very system focused and is supportive of the broader strategy of centers of excellence and a greater degree of facility service line specialization.

MSH and ISMMS have a common faculty and medical staff. Since the merger there has been great progress made in cross medical appointments between facilities and many physicians from the formerly Continuum hospitals are now faculty members of the school. There is a single management team for all of the system entities and the Dean of the medical school is highly integrated in the senior management team as well. Prior medical school affiliations were ended and switched to ISMMS. After the initial merger took place, the senior management team and board realized there were significant cultural differences across the system. As a result, senior management made numerous changes in the local campus management teams at the former Continuum facilities and the medical staff chairs than originally anticipated with a goal of improving productivity and functioning as a unified system.

Financial Profile

MSH's operating results have remained solid throughout the process of bringing the former Continuum facilities on board. The affirmation, in part, reflects the fact that MSH is the central engine of the Hospitals Group and is the obligated group member on the rated debt. Operating income at MSH was $71.5 million (3.5% operating margin) in 2014, which was up from $48.1 million (2.5%) in 2013. Standard & Poor's makes certain adjustments to the audited financials and includes third-party settlements in operations and moves contributions and investment income to non-operating. Excess income totaled $87.6 million (4.3% excess margin) in 2014, which was up from $76.7 million in 2013. Transfers to physician practices and receipt of distributions from related real estate companies are treated as changes in net assets. Overall coverage of MADS was sound at 3.3x in 2014. MADS generally declines over time, excluding a series of four bullet maturities over the next 10 years beginning in 2017. Management expects to refinance these bullets as they become due. Overall operating income and excess income for the Mount Sinai Hospitals Group in the aggregate was weaker than MSH alone. Operating income for the Hospitals Group was negative $43.1 million and was driven largely by losses at BI, although to a lesser extent by losses at SLR. Excess income was stronger at $55.1 million and includes positive adjustment to income from the captive insurance company. Overall MADS coverage was adequate at 2.9x.

Unrestricted cash and investments for MSH were solid at $1.1 billion and 216 days' cash on hand and a strong 186% of debt as of Dec. 31, 2014. However, the former Continuum hospitals were dilutive on the balance sheet as well as the income statement. Overall unrestricted cash and investments for the Hospitals Group in the aggregate was $1.4 billion, but just 116 days' cash on hand and an adequate 120% of debt. Overall unrestricted investments at the system level, including the medical school, were $1.6 billion excluding considerable permanently and temporarily restricted investments. The system's unrestricted cash and investments exclude the estimated market value of its non-clinical real estate holding, which management estimates at well over $1 billion.

Approximately 64% of MSH's investments are held in a pooled investment fund with ISMMS. The investment pool is diversified across asset exposures, strategies, and geographies. Hedge funds constitute about 55% and private investments 13% of the investment pool. Management can liquidate 21% of the pool in less than a month, 61% in less than six months, and over 80% can be liquidated within one year. The Hospital also holds a substantial amount of cash and cash equivalents totaling $477.6 as of Dec. 31, 2014.

MSH's investment in plant and equipment has remained strong for many years and in fiscal 2014 was a substantial 180% of depreciation. Overall average of plant has remained generally steady at or near 10 years.

Related Criteria And Research

Related Criteria

- USPF Criteria: Contingent Liquidity Risks, March 5, 2012
- USPF Criteria: Not-For-Profit Health Care, June 14, 2007
- 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
- Standard & Poor's Assigns Industry Risk Assessments To 38 Nonfinancial Corporate Industries, Nov. 20, 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

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