MOODY'S
INVESTORS SERVICE

Announcement: Moody's affirms Lakewood Hospital Association's (OH) Baa2 bond rating; Outlook revised to stable from negative

Global Credit Research - 20 Nov 2012

Rating action affects $11 million of outstanding debt

New York, November 20, 2012 -- Moody's Investors Service has affirmed the Baa2 bond rating for Lakewood Hospital Association (OH) (Lakewood). At this time, we are revising the outlook to stable from negative. The rating action affects $11 million of Series 2003A bonds issued through the City of Lakewood, Ohio.

SUMMARY RATINGS RATIONALE:

The Baa2 rating is based on a weak fundamental credit profile, including a moderate size and limited service array in a competitive Cleveland-area market, challenging demographics, continued operating losses and volume declines. These challenges suggest a rating level several notches below the current Baa2 rating level. However, Lakewood's rating heavily incorporates what we believe is a very strong and integrated relationship with the Cleveland Clinic Health System (CCHS) (rated Aa2), as discussed below, which is the sole corporate member of Lakewood. Additionally, the lease agreement under which CCHS leases Lakewood from the City of Lakewood includes a provision whereby if Lakewood Hospital's cash-to-debt (including bonds only) falls below one time, CCHS is required to transfer funds to Lakewood to meet that requirement. Additionally, the hospital has a low total debt level that is covered over 200% with unrestricted investments; bonded debt has over 400% coverage with investments.

Despite significant challenges, the affirmation and revision in outlook to stable from negative reflects a second year of reduced operating losses and uptick in revenue growth, driven in part by coordinated strategies with CCHS that have increased volume in certain service lines. Additionally, Lakewood's balance sheet metrics have stabilized.

STRENGTHS

*Strategic and financial benefits derived from Lakewood's status as a part of Aa2-rated Cleveland Clinic Health System (CCHS), which is the sole corporate member of Lakewood (the City of Lakewood owns the real assets of the hospital); additionally, an independent foundation holds approximately $26 million in investments, some of which may be available for capital

*Provision in lease which requires CCHS to ensure that Lakewood maintain 1:1 cash to debt

*Low debt level (16% debt-to-revenue) and adequate liquidity of 133 days as of August 31, 2012, which, despite declines, provides an ample 212% coverage of total debt

*Debt structure is low risk with all fixed rate debt and no swaps

*Improvement in operating performance in fiscal year 2011 and through eight months of fiscal year 2012, driven by an uptick in revenue growth of 7% in 2011 and 2% year-to-date 2012

CHALLENGES

*Despite recent improvement, operating margins remain weak with -2.4% operating and 3.7% operating cashflow margins through eight months of fiscal year 2012

*Continued large declines in acute admissions, partly offset by increases in sub-acute admissions and observations, as a result of location in a very competitive service area

*Further decline in unrestricted investment balance to $47 million as of August 31, 2012

*Challenging demographics resulting in high Medicare (49% of gross revenues) and high Medicaid and self-pay (combined 24%)

*Relatively high dependency on a large physician group for admissions

Outlook

The stable outlook reflects a second year of reduced operating losses and uptick in revenue growth, driven in part by coordinated strategies with CCHS that have increased volume in certain service lines. Additionally, Lakewood's balance sheet metrics have stabilized.

WHAT COULD CAUSE THE RATING TO GO UP

Given the hospital's volume challenges, a rating upgrade in the short-term is not likely. Over the longer-term, an upgrade would be considered with significant improvement in margins and reduction in debt and notable growth in admissions to better position Lakewood in a competitive market.

WHAT COULD CAUSE THE RATING TO GO DOWN

Further significant volume declines, inability to achieve further improvement in operating performance, further decline in cash, increase in debt without commensurate increase in cashflow; change in relationship with CCHS.

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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