Fitch Ratings

FITCH AFFIRMS VALLEY MEDICAL CENTER (WA) REVS AT 'A-'; OUTLOOK STABLE

Fitch Ratings-San Francisco-24 May 2012: Fitch Ratings has affirmed its 'A-' rating on the following Public Hospital District No. 1 of King County (Valley Medical Center), Washington revenue bonds:

--$22.6 million Public Hospital District No. 1 of King County, Washington (Valley Medical Center) Hospital Facilities Revenue Bonds, Series 2010A (Tax-Exempt)

--$61.2 million Public Hospital District No. 1 of King County, Washington (Valley Medical Center) Hospital Facilities Revenue Bonds, Series 2010B (Federally Taxable Build America Bonds)

The Rating Outlook is Stable.

SECURITY
Debt payments are secured by a pledge of the net revenues of the district, which exclude property tax revenue, and a combined debt service reserve fund.

KEY RATING DRIVERS

STRATEGIC ALLIANCE WITH UNIVERSITY OF WASHINGTON: Effective July 1, 2011, VMC became the eighth member of the University of Washington Medicine Health System (UW Medicine) pursuant to a Strategic Alliance Agreement executed between the District and UW Medicine. Along with becoming part of UW Medicine's clinically-integrated operating model, Fitch expects this alliance to expand VMC's brand, enhance its market share, and create beneficial operating synergies that should translate into stronger financial results.

FINANCIAL RATIOS LAG CATEGORY MEDIAN: Liquidity and operating cash flow margins have historically been below Fitch's A category median ratios and profitability is expected to be further compressed as VMC is incurring heavy operating expenses related to its information technology (IT) initiatives and growth strategies.

NEAR COMPLETION OF MAJOR PROJECTS: In July 2012, VMC will have completed construction and build-out of its new Emergency Services Tower, which is part of a large master facility plan begun in 2007. Additionally, in first quarter 2013, VMC will have completed construction of its urgent care facility in Covington (15 miles south of VMC's campus in Renton). Following completion of these projects, Fitch expects VMC to begin replenishing its balance sheet as capital needs begin to moderate.

STRONG MARKET SHARE: As the first and largest public hospital district in Washington State, VMC commands a large and leading 46% market share in its primary service area. Further, VMC is pursuing several growth strategies including expansion in the fast growing and desirable Covington area and acquisition of multiple physician groups.

INSUFFICIENT TAX REVENUE SUPPORT: VMC has taxing ability as a district hospital and has issued the majority of its debt through limited tax general obligation bonds (LTGO). Due to reductions in assessed property valuations the tax revenue needed to cover its LTGO debt service will be insufficient for fiscal 2012, which will place pressure on VMC's cash flow. This backfill of funds needed to cover LTGO debt service is expected to continue over the medium term given current property valuations.

WHAT COULD TRIGGER A RATING ACTION

FURTHER DETERIORATION IN CASH FLOW: Fitch believes VMC will have to prudently manage expense growth over the next 18 - 24 months so as to shore up operating cash flow. Additionally, Fitch expects VMC to bolster its balance sheet as capital spending begins to ebb. Failure to achieve measurable progress on these fronts could result in negative rating pressure.

CREDIT PROFILE

Public Hospital District No. 1 of King County (Valley Medical Center) comprises a hospital, licensed for 303 beds; eight primary care clinics in the South King County area; five urgent care clinics; several specialty clinics; and an occupational and behavioral health clinics. In fiscal 2011, VMC reported approximately $477.5 million in total operating revenue. VMC changed its fiscal year end to June 30 (beginning in 2012) from Dec. 31.

Strategic Alliance with UW Medicine

VMC has become a member of UW Medicine in the midst of other consolidation activity that has occurred within the greater Seattle metropolitan area. Fitch views this strategic alliance positively as it affords VMC the ability to integrate its clinical resources with UW Medicine's tertiary and quaternary clinical service lines; enhance its branding; solidify and increase its operating footprint and market share; and improve its managed care contracting and physician recruitment. Fitch also expects this alliance to lead to greater operational synergy and stronger financial results.

As a result, VMC is now managed as a component unit of the University of Washington and is governed by a new board (the VMC board) which comprises seven members from UW Medicine and five members from the District board. The District board (a publicly elected Board of Commissioners) governs Public Hospital District No. 1 of King County (the district) and owns the hospital, clinic network, and all other assets and liabilities. The District board oversees the district's property taxes and other non-healthcare related functions while VMC's board oversees the healthcare operations of the District.

Financial Performance Low for Rating Level

Operating cash flow has improved over the last three fiscal years but is still below the rating category median with 6.6% in fiscal 2009, 7.8% in fiscal 2010 and 8.7% in fiscal 2011 ($40 million operating EBITDA) compared to the 'A' category median of 9.4%. Interim results have dipped due to rising operating expenses related to implementation costs of VMC's electronic health record platform, higher labor expenses due to growing patient volume and expenses related to the acquisition of several physician practices and an infusion center. Through the nine months ended March 31, 2012, VMC reported an operating EBITDA margin of 7%. Operating results exclude approximately $20 million of property tax revenue, which is dedicated solely to support the LTGOs.

Balance sheet metrics exhibit low liquidity relative to expenses and debt. At March 31, 2012, VMC had $138.5 million in unrestricted cash and investments, which equated to 123.3 days cash on hand and cash to debt of 41.5% and compare unfavorably to Fitch's respective 'A' category medians of 194.1 days and 113.8%. Heavy spending on various capital projects has blunted balance sheet growth. The low cash to debt position reflects total outstanding debt, which includes $256.4 million of LTGO bonds and $83.7 million of revenue bonds.

Completion of Major Projects

VMC is nearing completion of major elements of its large master facility plan. Its new Emergency Services Tower opened in February 2010, and two of the remaining patient floors will be operational in July 2012. The added bed capacity is expected to be filled out from growing patient volume and expanded or added programs and service lines resulting from VMC's new alliance with UW Medicine.

In first quarter of 2013, VMC expects to complete its Covington project. The scope of the project has been revised to house urgent and primary and specialty ambulatory care instead of a free standing emergency department as originally envisioned.

VMC's capital budget for FY 2013 totals $30 million and addresses remaining funding needs at the Covington facility, completion of the emergency services tower project, and implementation of VMC's electronic healthcare record platform.

Debt Profile
Currently, VMC has $340.1 million in outstanding bonds: $256.4 million in LTGO bonds & $83.7 million in revenue bonds. All bonds are in fixed rate bonds. Maximum annual debt service totals approximately $25.6 million, of which $18.3 million is attributed to VMC's LTGO bonds. MADS coverage for total debt by EBITDA in 2011 was a weak 2.3 times (x) and dropped to 2.0x through the nine months ended March 31, 2012. However, MADS coverage of revenue bonds only is much stronger at 5.5x and 3.6x, respectively.

Insufficient Tax Revenue
The District was notified in late January 2012 by the King County Assessor's Office that the District-approved tax levied amount of approximately $20.1 million would be statutorily reduced in calendar year 2012 to approximately $16.7 million, which is no longer sufficient to cover LTGO MADS of $18.3 million at 1.0x. Given the increased reliance on VMC's revenue to cover the shortfall in LTGO debt service, Fitch will monitor VMC's performance relative to total debt outstanding, not just revenue bonds only.

Stable Outlook
The Stable Rating Outlook is predicated on Fitch's expectation that VMC will prudently manage expense growth over the next 18 -24 months and improve operating cash flow. Additionally, Fitch expects VMC to bolster its balance sheet as capital spending begins to ebb. Failure to achieve measurable progress on these fronts could result in negative rating pressure.

Disclosure
The District covenants to provide annual and quarterly disclosure through the Municipal Rule Making Board's EMMA system.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable Criteria and Related Research:
--'Revenue-Supported Rating Criteria' (June 20, 2011);
--'Nonprofit Hospitals and Health Systems Rating Criteria' (Aug. 12, 2011).

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Revenue-Supported Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=637130
Nonprofit Hospitals and Health Systems Rating Criteria
http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=648836