CREDIT OPINION
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Contacts

Nansis Hayek, CFA +1.212.553.6875
Analyst
nansis.hayek@moodys.com

Rita Strauss +1.212.553.3908
AVP-Analyst
rita.sverdlik@moodys.com

Maine Health & Higher Educ. Facs. Auth.

Update following upgrade to Aa3

Summary

Maine Health and Higher Educational Facilities Authority's (MHHEFA; Aa3 stable) credit quality will continue to reflect the moral obligation pledge of the State of Maine to replenish reserve fund draws and our view that this rating is higher than the pool program rating. The pool program rating reflects the relatively weak credit quality of the pool participants, high degree of concentration within the top five borrowers and low default tolerance. These challenges are offset by strong management and governance and a favorably-structured debt portfolio.

Credit strengths

» State is morally obligated to make up any deficiency in the reserve fund through annual appropriations

» MHHEFA is legally required to fund the reserve fund at maximum annual debt service

» Availability of significant additional operating funds at the Authority, a portion of which are pledged to bondholders

» Intercept provisions established under the MHHEFA Act

» Strong and tested oversight and administration of the program

Credit challenges

» High concentration of loans with the top five borrowers accounting for 75% of the pool debt

» Low average credit quality of the borrowers and low default tolerance score

» Majority of pool participants consist of healthcare organizations which are subject to greater operating pressures and variability compared to other borrowers

» Lingering impacts of the pandemic challenge patient volumes, enrollment and expenses

Rating outlook

The stable outlook reflects the stable outlook on the state of Maine's long-term obligation rating. Maine's stable outlook is based on expected maintenance of strong fund balances well in excess of 15% of revenue, structurally balanced operations, and moderate leverage compared to revenue. The stable outlook also applies to the state's general obligation, lease appropriation and moral obligation pledges and the Maine State Aid Intercept Program.

Factors that could lead to an upgrade

- Upgrade of the state's general obligation rating
- Material improvement in the credit strength and loan diversity of the underlying pool of borrowers

Factors that could lead to a downgrade

- Downgrade of the state's general obligation rating
- Change in the presumed strength of the state's moral obligation pledge

Profile

MHHEFA provides eligible non-profit colleges, universities and licensed healthcare facilities access to capital markets by issuing low cost, tax-exempt and taxable bonds and lending the proceeds to finance or refinance the acquisition, construction, and renovation of facilities.

Detailed credit considerations

Diversity of portfolio

The credit quality of program borrowers will continue to be pressured due to ongoing challenges related to the healthcare sector, including industry-wide staffing shortages driving up labor costs. Hospitals and entities owned by hospital systems will account for approximately 77% of pool debt.

MHHEFA is an independently-run pool program and an instrumentality of the state that issues low cost, tax-exempt and taxable revenue bonds to assist private, non-profit higher educational institutions and licensed non-profit healthcare providers with low cost financing for capital projects. The portfolio is currently comprised of 45 borrowers, though many smaller hospitals and nursing homes are owned or affiliated with larger hospital systems, reflecting ongoing consolidation in the state's healthcare sector. We assess the pool program's credit risk profile at the "parent" level, condensing the portfolio into 30 unique organizations, with somewhat differing degrees of legal or de facto control over their component units. Consequently, we calculate the top borrowers in the pool by considering any wholly-owned subsidiaries and their obligations as part of their parent health system; this includes subsidiaries that have their debt fully-guaranteed by the parent, as well as subsidiaries with debt that is not guaranteed.

Based on the approach outlined above, Northern Light Health is the largest borrower with $343 million of MHHEFA debt outstanding (approximately 42% of the pool). Northern Light's debt is spread across 8 affiliated organizations. Other large borrowers include MaineHealth System ($106 million or 13% pool debt), Central Maine Healthcare ($70 million or 9% pool debt), Northern Maine Medical Center ($52 million or 6% pool debt) and Maine Maritime Academy ($35 million or 4% pool debt). The next five largest borrowers in the pool are comprised of Hometown Health ($30 million or 4% pool debt), Maine Veteran's Homes ($21 million or 2.6% pool debt), Mount Desert Island Hospital ($15 million or 1.9% pool debt), Fish River Rural Health ($15 million or 1.8% pool debt) and Redington-Fairview General Hospital ($14 million or 1.7% pool debt). In total, there is a high degree of concentration among the pool's largest organizations, with the top five parent organizations in some way responsible for 75% of MHHEFA's outstanding debt and the top 10 organizations responsible for 87% of the total.

Credit strength and default tolerance

Two of the borrowers currently have stand-alone ratings: MaineHealth (A1 stable), Northern Light Health (Ba2 stable). Some obligors have issued debt outside of the pool program. We consider the increased leverage of the individual institutions from non-pool debt issuances as an additional factor in the credit quality of the portfolio. However, many of the portfolio participant's, especially the smaller institutions, sole debt offerings are through MHHEFA. Additionally, in 2020, management initiated a 5-year plan to rebuild the pool program with the goal of growing and diversifying the current participant pool. That said, based on Moody's internal assessment, the portfolio's debt-weighted average credit quality is relatively weak.

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Under the pool methodology, we also assess default tolerance, by using pool program projected cash flows to calculate or estimate the maximum percentage of revenue from loan repayments that a pool program could lose and still pay 100% of its debt service through the life of the bonds. MHHEFA's cash flows fund 1.0x debt service. Our projections of pool program projected cash flows incorporate other revenues pledged to the program debt as well as reserve funds or other pledged assets that mitigate revenue loss due to loan defaults. In addition to the DSRF, the presence of supplemental unrestricted liquidity is credit additive for the implied pool rating. MHHEFA has two key sources of liquidity on top of the required reserve fund. Approximately $22.6 million of supplemental reserves and $23.7 million of operating funds may be used to support debt service, although it is not legally obligated to do so. The Authority's investment portfolio is conservatively-weighted towards liquid, low-risk assets including US treasuries and other governmental obligations.

Healthcare borrowers will continue to face several challenges that will contribute to generally low credit quality. Challenges include relatively high bad debt and charity care, a labor shortage, as well as declining patient volumes. Overall, despite these challenges, many of the health systems in the top ten borrower group still have adequate debt measures because they carry relatively manageable debt loads. Additionally, healthcare providers do benefit from the state's fairly stringent and broad Certificate of Need regulations, which limits competition. Expansion of Medicaid will continue to help reduce bad debt and self-pay.

Educational borrowers represent 10% of the overall pool debt. MHHEFA serves a broad array of educational institutions, including private/not-for-profit colleges and universities, community colleges, and a private high school. The higher education sector in Maine has been more stable than the healthcare sector.

Debt structure: State's moral obligation pledge is a key rating factor

The pool is rated Aa3 based on the State of Maine's moral obligation pledge to appropriate amounts needed to make up for a deficiency in the DSRF after a draw to support debt service. The authorization to pledge the state's moral obligation commitment to replenish the capital reserve fund is included in the state statute. The debt service reserve fund requirement is sized at maximum annual debt service.

Debt service payments for the authority's bonds are due January 1 and July 1. Pursuant to statute, in the event of a shortfall in the DSRF, the authority will certify to the governor on or before December 1 each year the amount needed to restore the fund to the required level. According to the statute, the Governor must submit legislation to appropriate any amount required to restore the fund, but the Legislature is not legally bound to pass such legislation. Appropriation risk is one factor in the rating level of two notches below the state's general obligation bond rating. There is a potential timing limitation in the event that notification occurs on December 1 for DSRF replenishment by the following January 1, one month later. However, the authority is not precluded from notifying the governor of the need for appropriation before December 1. Given the authority's overall strong management characteristics, we believe early notification of a reserve fund draw would occur, providing sufficient time for a replenishment appropriation. The likelihood of a late or insufficient appropriation appears slim given the existing statute regarding the state's moral obligation and the substantial amount of debt supported by the state's moral obligation pledge. In addition, the state's various moral obligation-backed debt obligations have strong track records. Over three decades the state has not been called upon to honor the moral obligation pledge, highlighting the management strength of the different programs as well as the performance of the pledged revenues.

The State of Maine is rated Aa1 stable, reflecting robust financial reserves that will remain strong through at least the fiscal 2024-25 biennium and likely longer, given a structurally sound budget, conservative revenue projections and wide financial flexibility. Leverage from debt, pension, and OPEB liabilities is declining partly because of solid pension contribution practices and because of higher market discount rates Moody's uses to evaluate liabilities. Nonetheless, Maine's leverage remains above the median for US states because of the state's assumption of local teacher pension and OPEB liabilities. Maine's primary credit challenge is its older and aging population, reflected in its S-3 issuer profile score. While a recent increase in domestic migration has allowed the state to outperform the nation in real GDP growth the past few years, the state will likely revert to the trend of an older and declining population, based on Moody's projections. Such demographic headwinds contribute to slower employment and GDP growth, lower incomes, more limited tax revenue growth prospects, and greater reliance on federal transfer and retirement programs. The state's strong fiscal governance and ability to manage its finances and liabilities through these longer term challenges bolster its credit quality.

Finally, additional security is derived from intercept provisions established under the Maine Health and Higher Educational Facilities Authority Act. Under this act, the state treasurer is empowered to intercept funds within the states custody due to a borrower and

redirect these funds for debt service, if the Authority believes the borrower may default on its debt obligation and notifies the State Treasurer. While the mechanics of this provision are untested and not particularly specific, it provides an additional tool by which the Authority can ensure debt payments will be made before payments are due to bondholders.

Debt structure

All of MHHEFA's debt is fixed rate.

Legal Security

Bonds are secured by several, not joint, obligations of each loan participant pursuant to individual loan agreements and a reserve fund, which holds a moral obligation of the state to replenish any deficiency in those reserves. Each participant in a particular bond series enters into a loan agreement to repay their portion of the annual debt service obligation and share in funding the debt service reserve fund. In addition to the security of the Reserve Fund pursuant to the Reserve Fund Resolution, individual bond series are typically secured by mortgages and gross revenues of the participants in that series.

ESG considerations

Environmental

According to data from Moody's Climate on Demand, Maine is moderately exposed to climate risks related to extreme rainfall. Gross domestic product in Maine's coastal counties accounts for a significant 59.1% of the state's total, higher than the 50-state coastal county median of 38.6%. Housing in Maine is modestly exposed to flooding: 8.3% of coastal dwellings are in the 100/500 year flood plain compared with 16.8% of coastal dwellings for the US as a whole. Given Maine's location, the state is less exposed to property damage caused by hurricanes, but is more exposed to damage caused by severe winter storms. The governor's approach to combating climate change helps to mitigate these risks. The governor established the Maine Climate Council, which developed a four-year action plan to meet emission reduction goals and ensure climate change resiliency across the state. The state must achieve 80% renewable energy by 2030 by statute. State grant programs are being used by communities and regions for adaptation planning to support infrastructure upgrades based on coastal storm and flood risks. Prioritized state investments in clean energy innovation will also create new opportunities in workforce development. The governor's approach to combating climate change helps to mitigate these risks. The governor established the Maine Climate Council, which developed a four-year action plan to meet emission reduction goals and ensure climate change resiliency across the state. State grant programs are being used by communities and regions for adaptation planning to support infrastructure upgrades based on coastal storm and flood risks. Prioritized state investments in clean energy innovation will also create new opportunities in workforce development.

Social

The lingering impacts of the pandemic will contribute to revenue challenges at many of the borrowers, including lower patient volumes and enrollment, as well as higher pandemic-related costs. Industry-wide staffing shortages will continue to elevate labor costs for many of the pool's participants. Additional challenges will be the rural nature of many of the entities within the pool and the weak socio-economic characteristics of the state, such as an aging population, and declining working age population.

Governance

The Authority's well-established administration, monitoring procedures, and payment collection mechanisms will provide strong oversight of the program. Pending review of a borrower's finances and relevant statistical information, the Authority will approve initial loans to borrowers. The Authority will continue to monitor finances of borrowers based upon quarterly statements and annual audits to ensure the borrower's continued ability to meet debt obligations. The Authority also has additional indebtedness tests that limit a borrower's ability to incur debt outside of the program. For construction projects, the Authority requires signed bids before bonds are issued to limit construction cost overruns and a feasibility study for new services.

Monthly loan payment requirements will allow the Authority to identify potential financial stress ahead of semi-annual bond payments. Monthly loan payments are due on the 20th of every month except in June and December when payments are due on the 15th and are placed in a sinking fund account until semi-annual payments are due on January 1st and July 1st. If two monthly payments are missed, the Authority will become actively involved and initiate corrective measures.

The Authority's effective management of two bankruptcies of MHHEFA borrowers and other programs will support continued strong oversight. In 2019, MHHEFA stepped in to make monthly loan payments using its reserves on behalf of Penobscot Valley Hospital, who

filed Chapter 11 bankruptcy in January 2019. In 2015, MHHEFA executed a partial acceleration of bonds issued for Parkview Adventist Medical Center, following the hospital’s bankruptcy filing in June 2015 and its failure to make loan payments. The Authority used operating funds to make payments.

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