HIGHLAND ASSOCIATES REPORT ON THE INVESTMENT PROGRAM IN THE RATINGS PROCESS

The subsequent information is a summary of our conversations with Moody's and represents Highland's thoughts on best practices for our healthcare clients to make the rating process as smooth as possible. Where possible, we have listed specific items that Highland may help with; some are simply a refocus on existing efforts and others are new projects aimed at implementing the best practices detailed below. Again, this summary represents Highland's opinion and in no way should be interpreted as a directive from Moody's nor should it imply any endorsement by Moody's of the information detailed below. Also, the application of these ideas may differ for each client due to their unique needs and characteristics.

LIQUIDITY ANALYSIS- NEW RATIOS FOR NOT-FOR-PROFIT HEALTHCARE

Moody's recently released a new liquidity worksheet for their not-for-profit healthcare debt issuers. While Moody's has conducted a conference call to discuss the worksheet and its use in the rating review process, numerous questions still remain.

1.How does Moody's plan to use the worksheet?

The main reason for the new liquidity worksheet is to promote a better sense of what the overall liquidity profile of the healthcare industry looks like across issuers. Financial statements, footnote disclosures and asset class labels often do not tell the full story when looking at the investments of an organization. The liquidity of an investment has several factors – the nature of the underlying investments, the structure of the investment, etc. – that are often unclear in or absent from the audit and investment reports. This new worksheet establishes a better context from which to judge the liquidity of a given organization and to detail what cash could be available in a given period of time. It is likely that liquidity will be measured relative to the broader healthcare universe as well as based on the individual profile of each issuer.

This worksheet is not intended to replace any existing analysis completed on self liquidity programs which concentrate mainly on daily and weekly liquidity. While those short-term liquidity options are a component of this new worksheet, the new liquidity worksheet is geared more towards the overall liquidity of the investment program and will stand alongside any current liquidity analysis.

SUMMARY

Four members of the Highland Associates team visited the Moody's New York office on January 13, 2010 to meet with the senior members of the Not-for-Profit and Healthcare ratings team. The meeting was the culmination of numerous conversations between Highland and Moody's surrounding issues specific to our clients and the issues impacting the broader healthcare industry.

Highland Associates Participants:

•Bill Terry, CFA, Principal

•Mark Manderson, CFA, Consultant

•Michael Lytle, CFA, Consultant

•Mike Richards, CPA, CMA, Hospital Analytics

Moody's Participants:

• John Nelson, Managing Director, Healthcare, Higher Education & Not-for-Profit Public Finance Group

•Lisa Goldstein, Senior Vice President, Healthcare Ratings Group Team Leader

•Beth Wexler, Vice President, Healthcare Ratings Team

•Daniel Steingart, Analyst, Healthcare Ratings Team

Topics

• LIQUIDITY ANALYSIS

•HEALTHCARE INDUSTRY OUTLOOK

• TAX-EXEMPT DEBT MARKET

• HEALTHCARE MANAGEMENT AND PROGRAM GOVERNANCE

2.Does Moody's have targets for each of the 3 liquidity areas?

Not currently. As stated above, this initial information gathering exercise will give them a sense of what the market looks like in terms of liquidity. Looking forward, they will look for organizations to have a reasonable balance between debt and unrestricted and more liquid assets but those specific targets have yet to be determined.

3.Are those targets based on the rating of the issuer?

There will be a number of factors that influence the comparisons of each liquidity bucket. The issuer's current rating, debt structure, operating performance, budget, etc. will all play a role in determining the appropriate level for each of the liquidity buckets. Again, they will have a better sense after they have the liquidity detail on the full universe, but healthcare issuers should not be surprised to see a preference for more liquidity in the investment program as the debt/cash ratio rises and given a lower absolute rating for the issuer.

4.Does Moody's intend to apply discounts to less liquid assets? If so, what is the level of discount for each liquidity profile?

Not currently. This may come up in the future but it is not anticipated that discounts will be applied for current rating reviews.

5.How are the investment managers to be divided among the categories?

Broadly speaking, the contractual liquidity terms of the investments should determine where they are placed in the worksheet. Separate account managers and any commingled vehicles (mutual funds, common trust funds, etc.) that allow redemptions within 30 days with no contractual ability to refuse redemption requests (gates, suspensions, etc.) would be in the "monthly" category. "Annual" liquidity would include all managers with liquidity more than 30 days but less than 1 year – provided that they are not currently in wind-down or suspension. All other managers, including any manager that is currently in wind-down or suspension, would be included in the "liquidity with lockup > 1 year" category.

SUMMARY

The sense from our discussions was that this new liquidity worksheet would be used much like the overall healthcare operating medians that are calculated annually. They are to be used, at least initially, as a guide to see who the outliers are in the universe but then to really generate questions in the rating process. A common theme you will notice in our discussion is that Moody's focus really seems to be on the appropriateness and understanding of the investment program for and within each organization. So while there have to be broad market comparisons, there really is no absolute right or wrong answer (within reason). The main leveling factor in the analysis is the appropriateness of the strategy – both liquidity and investment – for the individual organization and the ability of management to explain and consistently implement that strategy. This is true for both operating and investment capital.

LIQUIDITY ANALYSIS:

How can Highland help?

Please contact your consultant at Highland Associates if you have any questions in how to categorize specific investment managers among the three main liquidity buckets for this first report. Going forward, Highland will provide a breakdown of each investment manager by liquidity bucket to aid in the annual reporting. Moody's also offered your specific analyst as a resource for questions, especially in this first round of reporting. It is also worth noting that Moody's indicated a willingness to adjust and adapt this form based on suggestions from issuers. So to the extent you have an issue that you feel they should consider, please share ideas with your analyst at Moody's.

HEALTHCARE INDUSTRY- CURRENT THOUGHTS AND OUTLOOK

2008 and 2009 were extremely challenging times for healthcare operations. Moody's lowered their outlook for the sector from stable to negative in November 2008 and with the ongoing stresses on federal and state budgets due to the current economic situation, the challenges are likely to persist for the foreseeable future.

1.What is Moody's seeing now in operating performance?

Operating performance for the industry as a whole has improved off the bottom in early 2009. Most of the improvement has been due to strong cost controls/ reductions and quick, decisive actions by both management and governing boards in response to the challenges that have arisen. The revenue side is still challenging but it has improved off the lows earlier in 2009. They did note that the larger systems seemed to weather the downturn better than smaller, single facility issuers that were less diversified by revenue base.

2.What impact does Moody's see from the pending national healthcare legislation?

It is still unclear what exactly will happen. Their sense was that volumes would likely rise, uninsured care would drop, but the payer mix would shift and margins were likely to see further pressure. The so called "public option" would put further pressure on margins though the recent US Senate election results in Massachusetts further complicates any forecasting.

3.Where does Moody's see the variable / fixed rate debt balance now?

The variable/fixed rate debt mix varies greatly based on rating level. Issuers in the Baa3 – Baa1 range averaged anywhere from no variable rate debt to as much as 20%. Issuers in the A3 – A1 range averaged 5-35% while Aa3 – Aa1 issuers averaged 50-65%. In all cases, the higher the rating, the higher the average level of variable rate debt. These figures were based on the underlying debt structure and did not account for swaps.

There are several factors that Moody's considers when evaluating the level and structure of variable rate debt:

a.Diversification of counterparty exposure
- i.Swap counterparties
- ii.Standby purchase agreements
- iii.Bank lines of credit

b.The ability of management to articulate and understand:
- i.Debt covenants and how many different covenants interact
- ii.Debt maturities and how they interact

c.Cash and investments coverage of variable rate debt (especially putable debt)

"2008 and 2009 were extremely challenging times for healthcare operations. Moody's lowered their outlook for the sector from stable to negative in November 2008 and with the ongoing stresses on federal and state budgets due to the current economic situation, the challenges are likely to persist for the foreseeable future."

There is no specific limit or "appropriate" level for variable rate debt. The level is very specific to the institution and is impacted by the size and liquidity of the investment program as well as management's understanding and ability to communicate the risks and interactions of operations, debt covenants, and the investment program.

4.How have recent swap collateral posting problems changed this?

Late 2008 and 2009 was marked by large swings in swap positions and the need for large collateral postings – putting heavy stress on healthcare issuers and their investment programs. That environment further emphasized the need for the investment program to match the liquidity profile of the organization and for a further examination of the notional swap exposure of the issuer versus their total debt outstanding.

5.How does pension funding impact the rating picture in Moody's opinion?

It is another factor in the rating picture with required contributions being a drain on liquidity.

SUMMARY

The sense from our discussions is that the industry is improving from the depths of the recession and market decline in early 2009. That said, the persistent budget constraints at the state and federal level along with the potential impact from national healthcare reform will continue to be a challenge for healthcare organizations. Moody's has their annual outlook call scheduled for January 28, 2010 at 3pm EST. Please contact your analyst for details if you have not already received the meeting notice.

TAX-EXEMPT DEBT MARKETS- CURRENT STATE OF THE MARKET

The tax-exempt market has improved dramatically from the depths of the auction rate security crisis in late 2008 and early 2009. A general improvement in the economy, a thawing of the credit markets, and some well aimed government programs (Build American Bond program) has made the financing environment more accessible to issuers.

1.What does Moody's see in the tax-exempt debt market?

While the negative outlook for the healthcare industry hurts a little relative to other tax-exempt issuers, the overall market has improved dramatically over the past 12 months. The Build America Bond (BAB) Program has provided a good deal of liquidity and drawn some attention back to the municipal market. Though the issues are taxable and only certain government sponsored healthcare entities can issue through the BAB Program as of now, the interest created by the Program has aided liquidity for all municipal issuers.

HEALTHCARE INDUSTRY OUTLOOK:

How can Highland help?

Our investment philosophy has always been centered upon designing a portfolio that matches the needs of each individual client. Different factors are important to each of our clients and we will continue to adapt and customize our strategy/approach according to the changing needs of our clients in this more challenging environment.

2.What proactive things can healthcare issuers do to help make themselves as attractive as possible in the tax-exempt market?

The biggest thing Moody's mentioned was an investor relations effort. This can be accomplished through using existing staff or even hiring a person to conduct a more proactive investor relations campaign but at a minimum, healthcare issuers should be very responsive to questions from investors in order to promote a positive image of their organization in the tax-exempt markets.

The other main suggestion was to publish financial information on an interim basis as often as is practical. Quarterly reports with meaningful management discussion and analysis and liquidity and budget disclosures on a routine basis would make a major difference in how the tax-exempt markets view you as an issuer when you come to market. Issuers must be mindful of any full disclosure regulations and should consult their legal advisors to ensure they comply.

3.Has the Auction Rate Securities market settled down and do they have any rating impact?

The majority of ARS have been refinanced over the past 12 months into other forms of variable debt. Those issues that still remain appear to be largely short-term in nature with fairly attractive rates at this point. So, there is not much concern over the existence of ARS anymore other than to be sure the liquidity provisions are matched up with the cash and investment strategy of the organization.

SUMMARY

The sense from our discussions was that the tax-exempt markets are improving and that reasonable and affordable financing is becoming more common. Therefore, healthcare issuers could do a better job in promoting themselves and being more transparent to the market on an interim basis to enhance their appeal in the tax-exempt markets. It is worth noting that PIMCO's municipal group advocates some form of investor relations effort as well. They feel it helps make investors more receptive to organizations that are less frequent issuers and not familiar names in the market.

HEALTHCARE MANAGEMENT AND INVESTMENT PROGRAM GOVERNANCE

Governance has been one of the largest areas of focus by investors coming out of the 2008-2009 market crisis. While what may be considered the most effective governance structure varies from organization to organization, the key pieces are the same – strong management team, educated and effective boards and committees, and an organization wide agreement on what is an acceptable level of risk.

TAX-EXEMPT DEBT MARKET:

How can Highland help?

Highland is not generally involved in the debt side of our clients but we are happy to help in any way we can in providing information on the investment program to aid in the investor relations process.

1.What are the factors that demonstrate "strong governance" in Moody's opinion?

On the operating side, steady and consistent performance, success of forecasting (performance versus budget), ability to explain any gaps between expectations and actual performance, and past success in running the organization and meeting goals are the key pieces that promote confidence in management. The keys on the investment side are really the ability of management to answer "why" questions about the program, the allocation and its implementation in a clear and concise manner along with a proper understanding of the risk of the program and its place in the overall organization.

2.The current market has made quicker action more common both in operations and in the investment portfolio. What does Moody's want to see to gain comfort in quick changes?

In the end, they want to see changes that were well planned out, methodically implemented, and that there is proof that the overall governance structure (board oversight) approved and aided in the changes. The key underlying theme in all of those steps is a clear understanding of the risk in the organization (both operationally and in the investment program) and management's ability to explain how any changes seek to address the level of risk. Communication by management of risk and the reasons for the changes is a big step in gaining comfort with any changes.

SUMMARY

The sense from our discussions was that management's ability to clearly explain strategy and results on both the operating side and in the investment program are the most important keys to demonstrating a solid governance structure. Underlying that thought is the existence of an effective education program for management as well as board and committee members on operating and investment program issues. The level of education effects the ability of board and committee members to have a positive influence on the long-term, strategic direction of the organization and management's level of education significantly impacts their ability to deliver on those goals.

HEALTHCARE MANAGEMENT AND INVESTMENT PROGRAM GOVERNANCE:

How can Highland help?

Education is one of the main missions of Highland Associates. Each organization has differing levels of sophistication across the governance structure so no two organizations have the same needs for education. Education programs can be customized so that the program is useful and practical for your unique needs. Additionally, Highland can help by providing a more concise summary of the investment program, its asset allocation, and its managers so that management can have a reference tool in discussions with outside stakeholders.

INVESTMENT PROGRAM AND INVESTMENT MANAGERS

The investment program is a key asset of a debt issuing organization and has a large impact on the rating of the organization. The program must address many of the factors detailed previously – liquidity, debt structure, etc. – but also has an important role in generating a return to contribute to the overall return on capital of the organization. The appropriateness of the asset allocation, required return, and liquidity of the investment program will vary by organization and by credit rating. In the end, there is no prescription for what constitutes an appropriate or proper allocation based on the rating of an organization. However, the ability of management to explain how the program reflects the needs (return, liquidity, etc.) and addresses the risk profile of the organization will have a major impact on the rating process.

1.Where is the tolerance around the 10% per manager threshold mentioned in previous special comment papers?

The general sense from our discussions was that the "10% rule" was really a guide and was mainly used to promote a dialogue with management. There are obviously differences between a core fixed income manager or cash manager that is above 10% and a single strategy hedge fund or other less liquid, more opaque investment that is above 10%. As with many of the issues discussed above, the guides here are intended to promote discussion and management's ability to explain why the position fits in to the overall objective of the investment program will have a larger impact than the exact size of the manager's position. The focus on exposure per manager really points to the risk posed to the overall program and what is the general level of diversification in the program. The goal is to get to the underlying investments and strategy employed in the program to be sure there is proper diversification.

For example, a program that uses only 1 investment manager but uses many different products from that manager to gain exposure across asset classes is not really diversified. While the program would be exposed to different asset classes, they would all be managed in the same manner with the same biases due to the common investment philosophy of that single manager. Additionally, a program that had several different managers in the same allocation – large cap value for instance – would not necessarily be diversified either since the underlying investments would be similar to regardless of any differences in investmentphilosophy between the managers. In the end, the focus is on the actual diversification of the program, not style boxes or manager names, and the appropriate level of risk in the program based on each individual organization.

"the ability of management to explain how the program reflects the needs (return, liquidity, etc.) and addresses the risk profile of the organization will have a major impact on the rating process"

2.How does Moody's view allocations to alternative asset classes?

While they have not taken a firm stance on alternatives broadly, the focus remains on the appropriateness of the strategy based on the risk and return goals of the organization, the ability of management to explain how alternatives fit into that picture, and the ability of management to demonstrate an effective due diligence effort both personally and through the use of outside parties (consultants).

The appropriateness of the use of alternatives varies based on each organization and their individual needs as well as the specific strategy and vehicle used. They have not taken a position on the use of direct investments versus fund of funds structures but the appropriateness of the investment is based on the same factors detailed previously:

a. Diversification offered by the investment

b. Liquidity of the investment

c. What the investment offers vs. a more traditional option

SUMMARY

The sense from our discussions was that management's ability to clearly explain the investment program is a major factor in the rating process. There is no roadmap in terms of what is an appropriate or proper allocation, how managers should be sized, or what is an appropriate use of alternatives. In the end the evaluation will center on the ability of management to explain how the strategy employed in the investment program – which is a significant piece of most organization's asset base – fits into the overall risk tolerance and strategic direction of the organization and then how the program is monitored.

INVESTMENT PROGRAM AND INVESTMENT MANAGERS:

How can Highland help?

As was mentioned before, Highland can help by providing a more concise summary of the investment program, its asset allocation, and its managers so that management can have a reference tool in discussions with outside stakeholders.

CONCLUSION

The purpose of our visit to Moody's and many of the past discussions with them was to get a sense of their view of the overall healthcare industry and the current dynamics, to understand how they view the investment program and how Highland could help our clients in the rating process. Based on our discussions, our sense is that the biggest factor they are focusing on now is liquidity and the interaction of the debt and investment sides of healthcare issuers. Consequently, the two most important things that our clients must do surrounding the investment program are:

1.Management must be able to clearly explain the investment program and its place in the overall capital base and strategic direction of the organization. Their ability to demonstrate an understanding of the overall risk and return goals for the portfolio as well as how the individual allocations and managers fit into that picture is a major piece of demonstrating an effective governance structure.

2.An ongoing education program for management and the governing boards and committees is the other key step in demonstrating an effective governance structure. While there is no magic formula for what to cover or how often to cover it, a program that fits the sophistication level of management and the board as well as the complexity of operations and the investment program will go a long way towards demonstrating an effective education and governance program. The content and frequency of the education sessions will vary by organization but every organization should, at a minimum, demonstrate that a routine orientation of the program has been completed to ensure that all members of the governance team understand the unique needs and risks of the program.

How can Highland help? We have detailed a variety of things that Highland can do to help accomplish the goals listed above. Some are a refining or refocusing of efforts that are already in place while there is some room for additional services that should hopefully smooth the rating process as much as possible.

1.Develop a more concise summary of the investment program that would be updated annually (or as needed) and could include detailed information on the plans in the program, detailed information on the investment managers focusing on the investment philosophy/strategy of the manager, their purpose in the portfolio, and the structure and liquidity of the investment and a breakdown of the investment managers by Moody's categories of liquidity (monthly, annual, more than annual).

CONCLUSION

How can Highland help?

We have detailed a variety of things that Highland can do to help accomplish the goals listed above. Some are a refining or refocusing of efforts that are already in place while there is some room for additional services that should hopefully smooth the rating process as much as possible.

2.Refine the existing investment education plan for management and any governing boards or committees. Obviously the specific plan will vary by client based on the individual needs and the time allotted for education in the regular meeting process but some plan should be detailed in order to accomplish this goal. Highland would suggest, to the extent that one has not been completed recently, that management and the governing board or committee complete our risk survey during 2010. This allows each member of the governance process the opportunity to request education on a variety of topics and also serves as a solid gauge for the risk tolerance and return goals for the investment program. This type of review is especially useful after the 2008-2009 market turmoil to ensure the focus has not changed.

3.Many of our clients have made significant changes to their capital structure over the past 12-18 months due to new bond issues, refinancing, or other liquidity events. While the investment portfolio is always designed with the overall capital structure of the organization in mind, 2010 would be a good time to take a more complete look at the interaction of the debt and investment sides of each individual organization to ensure that the investment program has the proper return and liquidity profile to meet the needs of each organization going forward.

We are excited about the information we have been able to gather and share with you at this time. We fully intend to continue these discussions with Moody's and other similar groups and will share our findings from those parties as well. Your consultant will be in contact with you over the next month to discuss this information and how Highland can continue to provide you with the best possible service.

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