Nonprofit Acute Health Care 2022: Trends Impacting Hospital Bond Ratings

June 22, 2022

California Hospital Association

1

Welcome

Chad Mulvany
Vice President, Policy
California Hospital Association

California Hospital Association

2

Continuing Education

Continuing education hours are offered for this program for health care executives.

Full attendance and completion of the online evaluation and attestation of attendance are required to receive CEs for this webinar.

3

Questions

We will take questions as they come through out the presentation. There is also some time built into the presentation for questions and comments at the end.

Please submit your questions using the Q&A box (usually located at the bottom of your screen) as they come to you throughout the presentation.

4

Presenter

Chloe A. Pickett
Associate Director, U.S. Public Finance
S&P Global Ratings

Chloe Pickett is an Associate Director in the health care group of U.S. Public Finance. Chloe works on all areas of not-for-profit health care analysis, focusing on health care systems, stand-alone acute care hospitals, and specialty hospitals. While based in the Centennial, Colorado, she covers credits for organizations throughout the United States.

5

Presenter

Aamna Shah
Associate Director, Healthcare, U.S. Public Finance
S&P Global Ratings

Aamna Shah has been with S&P Global Ratings since 2016 and is based out of the San Francisco office. She is an Associate Director for the U.S. Public Finance team covering the credit of not-for-profit standalone hospitals, large health care systems, as well as long term care facilities. Her coverage area spans the entire continental U.S. but most specifically the Midwest and West Coast regions.

6

U.S. Public Finance
Not-For-Profit Health Care
California: What We're Watching

California Hospital Association
June 22, 2022

Chloe Pickett, Associate Director
Aamna Shah, Associate Director

S&P Global
Ratings

7

Objectives

- Provide an overview of S&P's not-for-profit health care universe and criteria
- Discuss S&P's sector outlook and trends in 2022 and beyond
- Describe the unique characteristics of California providers and how they compare to the sector portfolio
- Q&A

S&P Global
Ratings

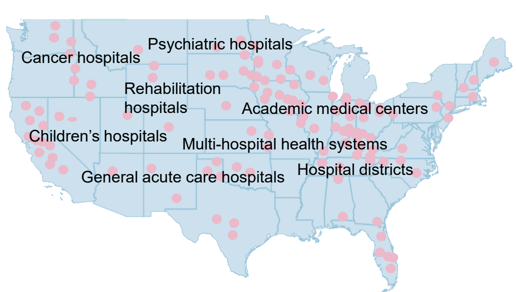
8

Not-For-Profit Healthcare Universe and Criteria

S&P Global
Ratings

U.S. Not-For-Profit Health Care Ratings Universe

- Not-for-profit, acute care stand-alone hospitals and health care systems, senior living facilities, and human service providers (approximately 500 ratings in total).



Latest criteria update:

Revised criteria for U.S. and Canadian Not-For-Profit Acute Care Health Care Organizations released

March 19, 2018

S&P Global
Ratings

Operating revenues ranging from $89 billion to $16 million

AA- stable
Kaiser Permanente
TOR: $88,700 million

A- stable
CommonSpirit Health
TOR: $32,700 million

AA+ stable
Ascension Health Alliance
TOR: $27,200 million

A+ negative
Providence St. Joseph
TOR: $27,200 million

BBB- stable
Shodair Children's
TOR: $41.2 million

BB stable
Bibb County Healthcare Auth.
TOR: $24.5 million

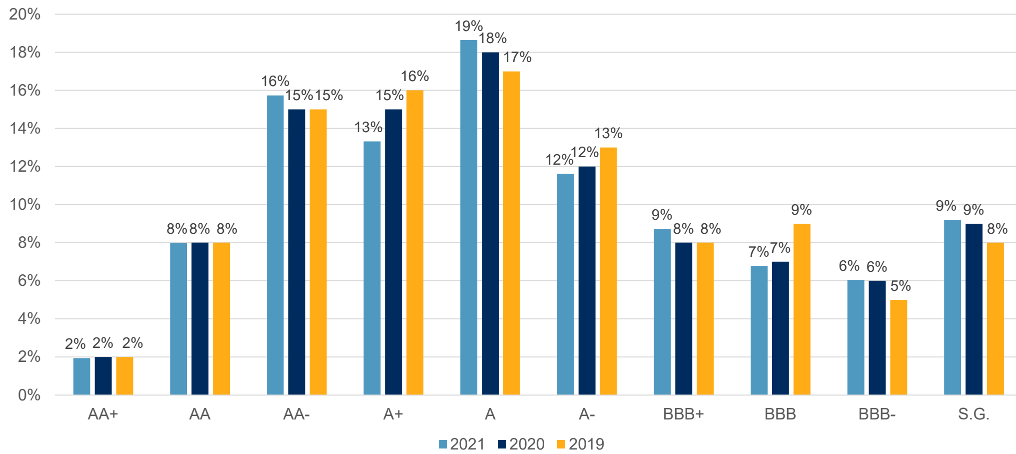
CCC positive
Dawson County Hospital District
TOR: $23.5 million

BB+ stable
Winkler County Hospital District
TOR: $15.5 million

As of March 31, 2022

S&P Global Ratings

Not-For-Profit Acute Health Care Rating Distribution



S&P Global Ratings

U.S. Not-For-Profit Acute Health Care Criteria Overview

Enterprise Profile Assessment

Economic Fundamentals (20%)
- Demographic profile
- Geographic diversity

Industry Risk (20%)
- Economic cyclicality
- Competitive risk and growth

Market Position (50%)

Stand-Alone Hospitals
- Market share, competition and demand
- Medical staff
- Payer mix
- Clinical quality

Health Care Systems
- Diversity
- Integration and scale
- Market specific considerations

Management and Governance (10%)
- Strategic positioning
- Risk management
- Organizational effectiveness
- Governance

- Assesses operating environment and incorporates broad industry and organization-specific factors.
- Assessments for each factor range from 1 (strongest) to 6 (weakest) based on a combination of quantitative and qualitative factors.

S&P Global Ratings

U.S. Not-For-Profit Acute Health Care Criteria Overview (contd.)

Financial Profile Assessment

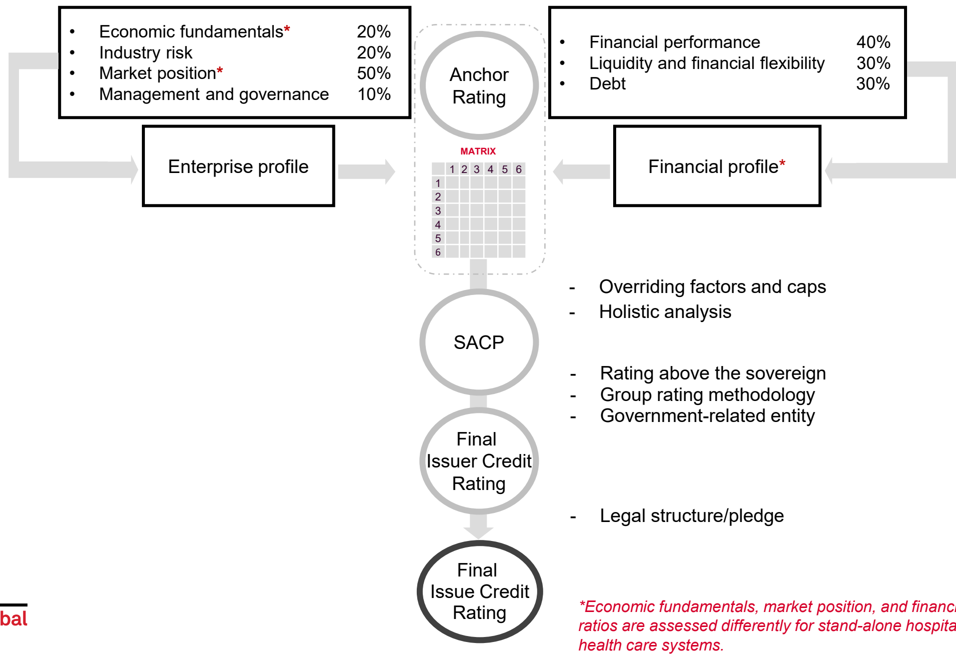
Financial performance (40%)
- Total operating revenue
- Earnings before depreciation, interest and amortization (EBIDA) margin
- Operating margin
- Excess margin
- Maximum annual debt service coverage
- Lease-adjusted MADS coverage

Liquidity and Financial Flexibility (30%)
- Average age of plant
- Capital expenditures/depreciation expense
- Days' cash on hand
- Unrestricted reserves/long-term debt
- Unrestricted reserves/contingent liabilities

Debt (30%)
- Debt burden
- Long-term debt/capitalization
- Contingent liabilities/long-term debt
- Funded status of defined-benefit pension plan

- Assesses the financial strength of health care organizations.
- Assessments for each factor range from 1 (strongest) to 6 (weakest) based on a combination of quantitative and qualitative factors.

S&P Global Ratings



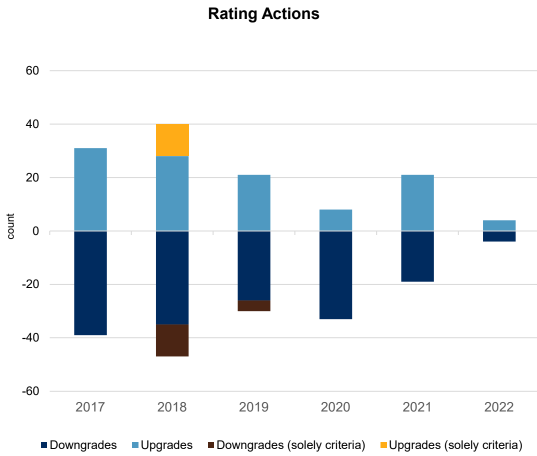
*Economic fundamentals, market position, and financial profile ratios are assessed differently for stand-alone hospitals and health care systems.

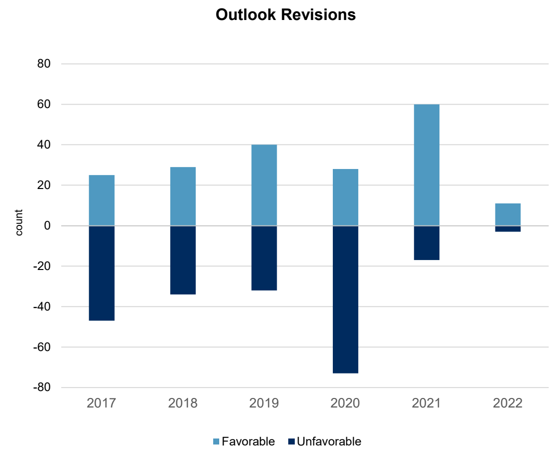
S&P Global Ratings

U.S. Not-For-Profit Healthcare Sector Outlook

S&P Global Ratings

2022 Not-For-Profit Acute Health Care Sector View: Stable

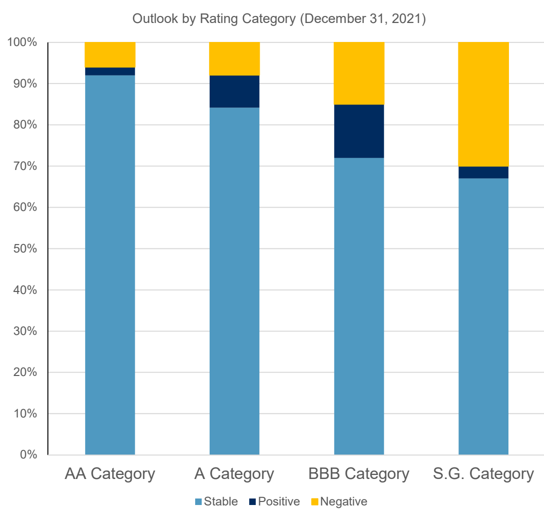




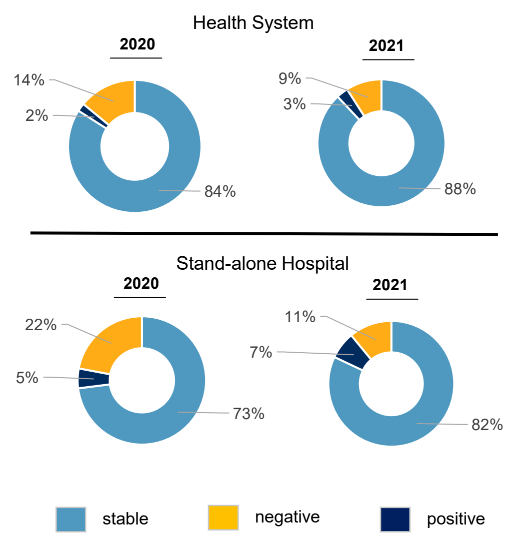
Data for 2022 as of Mar, 31, 2022. Excludes three organizations with developing outlooks.. Rating Actions: Data represents all ratings reviewed including some with multiple rating actions. Criteria actions in 2018 and 2019 relate to "U.S. And Canadian Not-For-Profit Acute-care Health Care Organizations" criteria, published March 19, 2018. Outlook Revisions: All outlook changes unaccompanied by a rating change. Favorable outlook revisions include stable to positive and negative to stable. Unfavorable outlook revisions include positive to stable and stable to negative.

S&P Global
Ratings

2022 Not-For-Profit Acute Health Care Sector View: Stable



As of Dec. 31 for respective years. . Exclude organizations on CreditWatch or developing outlooks..



S&P Global
Ratings

What We're Watching - U.S. Not-For-Profit Acute Health Care

Expense pressures

Inflation and labor-related expenses are likely to present the largest headwind over the next year.

Volume and revenue trends

As COVID-19 continues to circulate, related governmental support wanes, and staffing shortages persist, volumes and revenue could remain uneven.

Maintenance of balance sheet strength

Balance sheet strength will be critical for sustaining credit stability at a time of increased operating pressures and catchup on deferred capital spending.

Federal actions

Legislative and policy initiatives could support or deter the ability of hospitals to meet targets and goals.

COVID-19's impact on trends

Data and technology could improve care delivery and efficiencies, and evolving payment and operating models are likely to accelerate as affordability remains at forefront.

ESG risks

Climate change, cybersecurity, and social capital will continue to present challenges to credits in 2022.

Widening credit quality gap

Credit quality gap between stronger and weaker rated providers likely to continue to grow.

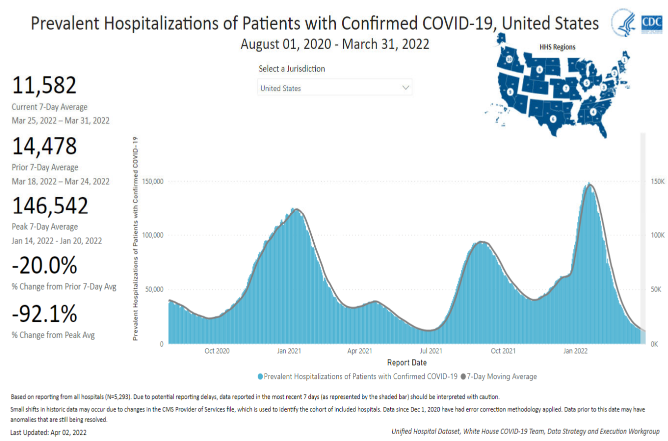
How Does the Broader Macroeconomic Environment Affect the Sector?

- **GDP growth**: Investment performance, payor mix dilution
- **Supply chain:** Inflationary pressures on operating expenses
- **Labor force:** Labor shortages increasing salaries/wages, reduced operating capacity
- **Unemployment:** Payor mix dilution, increased Medicaid/uninsured patients
- **The Fed:** Increased cost of borrowing/capital, pension discount rate assumptions
- **Recession:** Investment performance, payor mix dilution

May 4, 2022 update: Our qualitative assessment of recession risk over the next 12 months is now about **30%**. Given the heightened uncertainty, we're setting the **range at 25%-35%.** Because of the lag in monetary policy impact on the economy, we see recession risks greater in 2023.

Questions That Matter:
What's next with the pandemic?

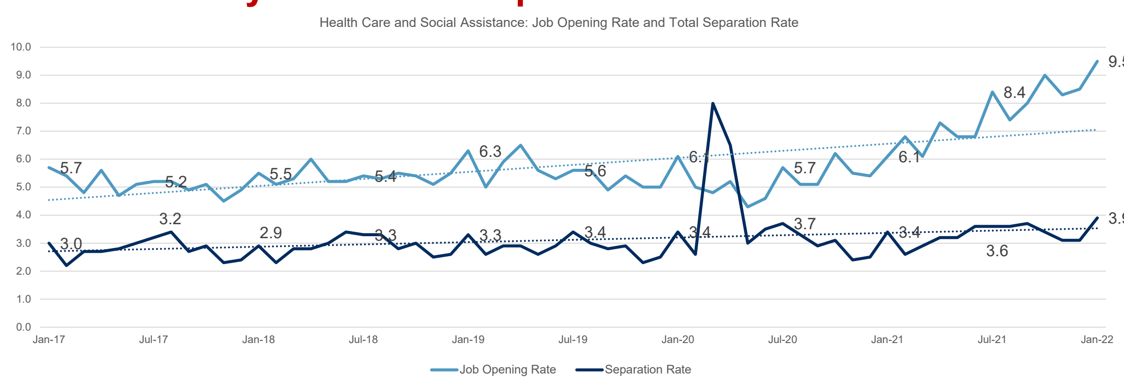
- Ongoing waves could continue to occur, but vaccinations, therapies, and drugs could temper impact to hospitals over time.
- Variants remain an uncertainty.
- Relief funds likely to be more limited, as other pandemic support will wane.
- As attention lessens, global vaccination rates could also be factor.



Source: https://covid.cdc.gov/covid-data-tracker/#hospitalizations

S&P Global
Ratings

Questions That Matter:
How will labor dynamics affect providers?

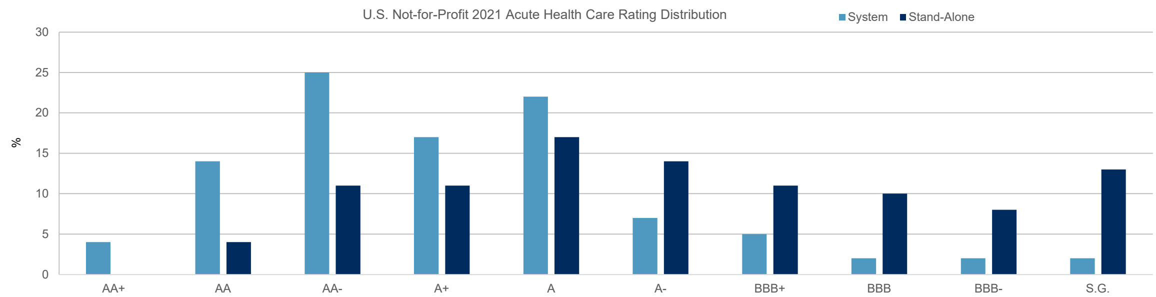


- Ability to absorb higher staffing and labor expenses is a key credit focus and it is uneven geographically.
- Investment in workforce and well-being will be critical but will add additional expenses.
- Acceleration of technology innovations to manage care could provide some relief but likely in out years.

Source: Bureau of Labor Statistics; Seasonally non-adjusted rates.

S&P Global
Ratings

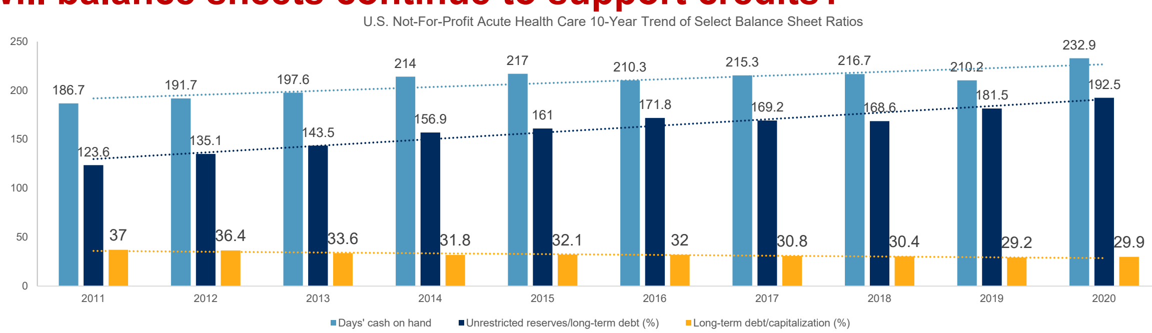
Questions That Matter:
Which credits can manage operating margin compression?



- In addition to labor, other expenses and supplies will continue to impact margins and investment market weakening could impact non-operating income and overall cash flow.
- Management actions, including payor negotiations, could help to temper performance pressures.
- Location and credit characteristics matter, influenced by market position, payor mix, and demographics.

S&P Global Ratings

Questions That Matter:
Will balance sheets continue to support credits?



- Organizations with strong balance sheets are less likely to experience a negative rating or outlook action.
- Sustained investment market challenges would be limiting factor.
- Low interest rates have allowed for cost efficient access to capital and liquidity; however, increasing interest rates could change this.
- Increased spending is likely and could dampen balance sheet strength if cash flow remains light.

S&P Global Ratings

Questions That Matter:
What other factors could affect the sector in 2022?

Data & technology help support providers as they focus on being value ready, even if payment models are slow to shift.

Effectively harnessing data and technology to improve clinical care and efficiency.

Partnerships & affiliations for efficiencies and strategic investments likely to continue.

Legislative and policy areas remain an area that could support or hamper credit quality.

S&P Global
Ratings

California: What We Are Watching

S&P Global
Ratings

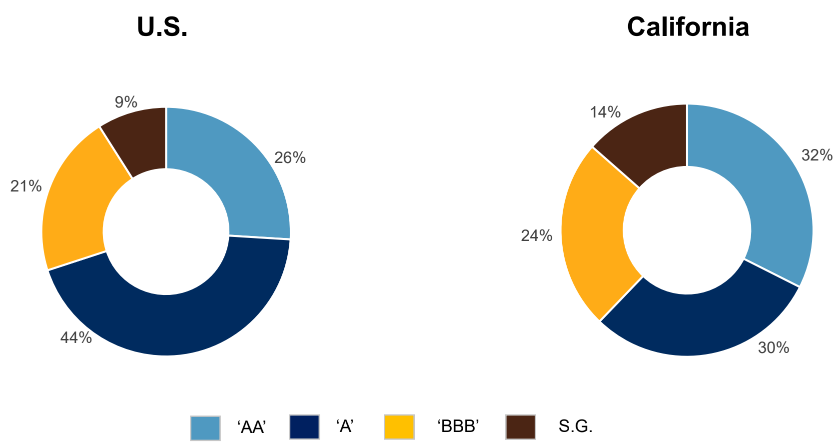
KAISER PERMANENTE
Adventist Health
SHARP
Cedars Sinai
LOMA LINDA UNIVERSITY HEALTH
Cottage Health
Children's Hospital LOS ANGELES
PALOMAR HEALTH
City of Hope
Sutter Health
Valley Children's HOSPITAL
hoag
Barlow RESPIRATORY HOSPITAL
MONTAGE Health
MemorialCare
CHOC
NORTHBAY HEALTHCARE
MAMMOTH HOSPITAL
Scripps
PIH HEALTH
Stanford HEALTH CARE
Methodist Hospital
SAN ANTONIO REGIONAL HOSPITAL
marin health
Lucile Packard Children's Hospital Stanford
Emanate Health
CASA COLINA CENTERS FOR REHABILITATION
Oak Valley Hospital District
JOHN MUIR HEALTH
El Camino Health
Redlands Community Hospital
BeverlyHospital
Oroville Hospital
Henry Mayo Newhall Hospital
ANTELOPE VALLEY HOSPITAL
COMMUNITY MEDICAL CENTERS
NORTHERN INYO HOSPITAL

S&P Global Ratings

27

27

Not-For-Profit Acute Health Care Rating Distribution Comparison



U.S. - As of Mar. 31, 2022.

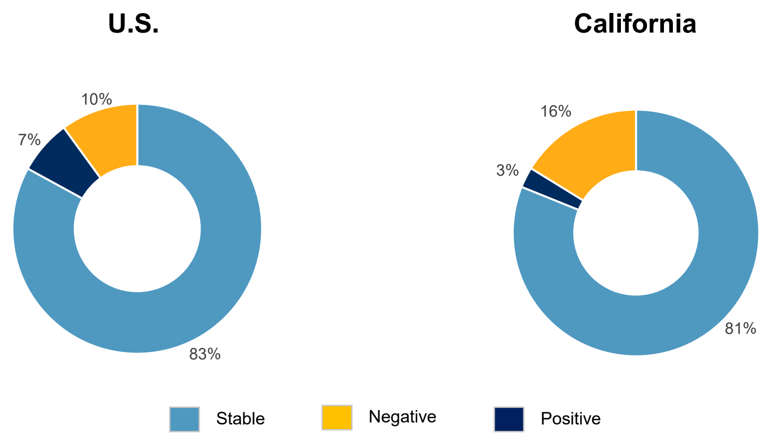
California – As of May 31, 2022

S&P Global Ratings

28

28

Not-For-Profit Acute Health Care Outlook Distribution Comparison



U.S. - As of Mar. 31, 2022.

California – As of May 31, 2022

What We're Watching: Staffing Pressures

California's labor market is influenced by staffing regulations and collective bargaining

– Nursing shortage in line with national trends.

– California is the only state that caps the number of patients assigned to a single nurse across all specialties, exacerbating staffing pressures.

– 60% of rated providers have staff with some level of participation in collective bargaining agreements.

What We're Watching: Diverse economic fundamentals

Diverse economic indicators may lead to varied demand characteristics

– California's shortage of affordable housing, high social service costs and income disparity have challenged social capital demographic trends.
– Diversity in size and scale of health care providers.
– Primary service area populations range from over 60 million across multiple state jurisdictions to under 15,000.
– Majority of providers exhibit extremely or very strong economic fundamentals based on the primary service area population with population and employment growth in line with national averages.

S&P Global
Ratings

What We're Watching: Market consolidation and nontraditional competition

Competitive dynamics vary across the state

– California is not a certificate of need state allowing hospitals and health systems to expand with less barriers.
– Consolidation somewhat capped in Northern California and San Diego.
– Parts of Southern California present opportunities for consolidation as the market is quite fragmented.
– Unique geography and high demand for health care services incentivizes non-traditional competition.
– Physician alignment challenged by California regulations on direct physician employment.

S&P Global
Ratings

What We're Watching: Environmental risk factors

Earthquakes and wildfires are California's key environmental risk factors

- Our credit rating analysis for California providers incorporates a moderately negative influence from environmental physical risks including acute and chronic wildfire events and natural disasters, such as earthquakes.
- Many California providers exposed to wildfires which can result in disruption to operations or large scale property damage.
- Seismic requirements may impact credit rating profiles as we approach the 2030 deadline, as substantial capital plans could strain balance sheets limiting upward credit rating potential.
- Over the longer-term, pervasive drought conditions, particularly in certain parts of the state, could become a more material and visible risk in our credit rating analysis if areas become undesirable and affect population and demographic trends.

S&P Global
Ratings

What We're Watching: Quality assurance fee and supplemental funding

Quality assurance fee is positive for many credits there are ongoing cash flow delays

- One-third of the state's population relies on Medi-Cal.
- Supplemental funding comprises a material component of operating margins for many California providers.
- Quality assurance fee program subject to renewal and approval from CMS – delays in renewal periods may impact receipt and recognition of funding from the program.
- Providers reliant on supplemental funds may experience operating pressure and uneven cash flow.

S&P Global
Ratings

California Not-For-Profit Acute Health Care Selected Medians

2020 vs. 2019

	California		All acute care	
	2020	**2019**	**2020**	**2019**
Sample size	40	41	399	395
Statement of operations				
Net patient revenue (NPR; $000)	669,193	697,322	900,920	922,974
Total operating revenue ($000)	798,687	816,840	1,046,825	1,014,342
Salaries & benefits/NPR (%)	55.1	52.7	60.2	56.7
Maximum annual debt service coverage (x)	2.8	3.6	3.9	3.9
Operating lease-adjusted coverage (x)*	2.2	2.8	3.1	3.2
Debt burden (%)	2.9	2.9	2.4	2.4
EBIDA ($000)	96,535	82,228	90,167	100,739
Nonoperating revenue/total revenue (%)	2.2	2.1	1.8	1.9
EBIDA margin (%)	9.6	11.6	9.5	10.0
Operating EBIDA margin (%)	7.1	8.9	7.6	8.4
Operating margin (%)	1.3	3.7	1.6	2.3
Excess margin (%)	3.2	6.1	3.4	4.1
Capital expenditures/depr. & amort. exp. (%)	108.0	131.9	112.9	119.3
Balance sheet				
Average age of plant (years)	11.6	11.2	11.8	11.5
Cushion ratio (x)	21.7	19.3	24.8	23.0
Days' cash on hand	193.0	186.4	232.9	210.2
Days in accounts receivable	50.2	53.6	45.1	47.6
Cash flow/total liabilities (%)	9.5	15.1	11.6	15.5
Unrestricted reserves ($000)	519,642	421,079	680,185	553,019
Unrestricted reserves/long-term debt (%)	154.3	134.1	192.5	181.5
Unrestricted reserves/contingent liab. (%)*	851.7	729.0	775.4	650.1
Contingent liabilities/long-term debt (%)*	15.4	22.1	26.6	28.7
Long-term debt/capitalization (%)	27.7	29.9	29.9	29.2
DB pension funded status (%)*	81.4	83.5	80.7	81.8
Pension-adjusted long-term debt/capitalization (%)*	29.9	33.8	32.1	31.7

*These five ratios are only for organizations that have defined-benefit (DB) pension plans, operating leases, or contingent liabilities. Includes stand-alone hospitals and health care systems. MNR--median not reported. Fiscal 2019 and 2020 medians are based on audited fiscal years and ratings as of June 30, 2020, and June 30, 2021, respectively.

S&P Global Ratings

California Not-For-Profit Acute Health Care Selected Medians

Audited 2021 Preview

	California		
	2021	**2020**	**2019**
Sample size	32	40	41
Statement of operations			
Net patient revenue (NPR; $000)	1,049,162	669,193	697,322
Total operating revenue ($000)	1,225,958	798,687	816,840
Salaries & benefits/NPR (%)	54.3	55.1	52.7
Maximum annual debt service coverage (x)	3.7	2.8	3.6
Operating lease-adjusted coverage (x)*	3.2	2.2	2.8
Debt burden (%)	2.5	2.9	2.9
EBIDA ($000)	119,019	96,535	82,228
Nonoperating revenue/total revenue (%)	3.2	2.2	2.1
EBIDA margin (%)	10.8	9.6	11.6
Operating EBIDA margin (%)	6.9	7.1	8.9
Operating margin (%)	0.5	1.3	3.7
Excess margin (%)	4.3	3.2	6.1
Capital expenditures/depr. & amort. exp. (%)	99.9	108.0	131.9
Balance sheet			
Average age of plant (years)	11.4	11.6	11.2
Cushion ratio (x)	28.4	21.7	19.3
Days' cash on hand	348.7	193.0	186.4
Days in accounts receivable	58.5	50.2	53.6
Cash flow/total liabilities (%)	11.8	9.5	15.1
Unrestricted reserves ($000)	1,019,198	519,642	421,079
Unrestricted reserves/long-term debt (%)	251.0	154.3	134.1
Unrestricted reserves/contingent liab. (%)*	1,547.5	851.7	729.0
Contingent liabilities/long-term debt (%)*	13.1	15.4	22.1
Long-term debt/capitalization (%)	25.4	27.7	29.9
DB pension funded status (%)*	96.6	81.4	83.5
Pension-adjusted long-term debt/capitalization (%)*	26.1	29.9	33.8

- Not all Dec. 31, 2021 fiscal year audits yet available.
- Financial performance has weakened significantly from fiscal 2020
- Balance sheet metrics improved, impacted by new issuer with robust balance sheet

*These five ratios are only for organizations that have defined-benefit (DB) pension plans, operating leases, or contingent liabilities. Includes stand-alone hospitals and health care systems. MNR--median not reported. Fiscal 2019 and 2020 medians are based on audited fiscal years and ratings as of June 30, 2020, and June 30, 2021, respectively.

S&P Global Ratings

spglobal.com/ratings

S&P Global
Ratings

Q&A

S&P Global
Ratings

Contact

Chad Mulvany
Vice President, Policy
California Hospital Association
cmulvany@calhospital.org

Chloe Pickett
Associate Director, U.S. Public Finance
S&P Global Ratings
Centennial, CO
T: 303.721.4122
chloe.pickett@spglobal.com

Aamna Shah
Associate Director, Healthcare, U.S. Public Finance
S&P Global Ratings
San Francisco, CA
T: 650-272-8188
aamna.shah@spglobal.com

39

39

Thank You

Thank you for participating in today's webinar.

An online evaluation and an attestation of attendance will be sent to you shortly.

For education questions, contact:
education@calhospital.org

40

40