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California Health Facilities Financing Authority Adventist Health System/West; Joint Criteria; System

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California Health Facilities Finance Authority (Adventist Health System/West)

Long Term Rating

A/Stable

Affirmed

Rating Action

S&P Global Ratings affirmed its 'A' long-term rating and underlying rating (SPUR) on debt issued by various entities for Adventist Health System/West (Adventist Health). The outlook is stable.

We also affirmed our 'AA/A-1+' rating on Adventist Health's series 2009B bonds. The long-term component of the rating is based on the application of our joint criteria (assuming medium correlation) reflecting the ratings on U.S. Bank and Adventist Health. We base the short-term component solely on U.S. Bank's letter of credit, which expires Jan. 10, 2024.

Credit overview

The rating reflects our view of Adventist Health's sizable geographic and revenue diversity, with 22 hospitals operating across three states, as well as management's efforts over the past several years to align the system's hospitals. The rating also incorporates our view of Adventist Health's financial profile, highlighted by somewhat volatile operations; and our view of the system's stable, albeit only-adequate balance sheet. Adventist Health's operating margin has weakened over the past 18 months, including a sizable operating loss in fiscal 2019, although this loss was largely attributable to revenue cycle challenges that have since been resolved. The system's management team has significantly restructured its revenue cycle, and has implemented a number of revenue-enhancement and cost-saving initiatives.

Although its financial performance has improved from fiscal 2019 levels, Adventist Health experienced operating strain through the six-month interim period ended June 30, 2020, due to the COVID-19 pandemic. With the onset of COVID-19 and subsequent cessation of non-emergency procedures, the system experienced dramatic volume reductions starting in mid-March. Through June 30, 2020, operations are stabilizing, as volumes have improved to near historical levels, although emergency department volumes remain compressed. Providing further stabilization, Adventist received \$218 million in funding from the Coronavirus Aid, Relief, and Economic Security (CARES) Act through June 30, 2020, and an additional \$67 million in July. We expect operations will improve through year-end as volumes continue to recover and management implements various cost-saving initiatives. However, while we believe Adventist Health has some capacity to absorb the current strain on its financial metrics, additional stress to operations over the outlook period could cause us to revise that view.

The stable outlook reflects our view of Adventist Health's consistent balance sheet, which lends moderate stability to the system through operating strain over the past 18 months, combined with the system's solid enterprise profile, with good revenue and earnings diversity. The outlook also reflects our view that Adventist Health will improve operations and maximum annual debt service (MADS) coverage over the outlook period as volumes continue to rebound.

The ratings and outlook reflect our view of Adventist Health's:

- Operating size and scale, with 22 hospitals in three western states;
- Solid operating liquidity, as measured by days' cash on hand; and
- Standardization and centralization of administrative process over the past several years, generating consistency and cost savings.

In our opinion, offsetting credit factors precluding a higher rating include Adventist Health's:

- Balance sheet metrics that remain slightly weak for the rating, notably debt to capitalization and unrestricted reserves to debt;
- Modest MADS coverage in fiscal 2019 and the first half of fiscal 2020; and
- Operations in challenging markets across the system, with a high concentration of government payers, and a heavy reliance on special funding programs.

Environmental, social, and risk factors

We view Adventist Health's overall environmental risks as elevated relative to those of industry peers, given its location in markets that are historically prone to earthquakes and wildfires, particularly in recent years. Mitigating the earthquake risk is Adventist Health's investment in capital to comply with 2030 seismic guidelines. In November 2018, Feather River, a 100-bed hospital in Paradise, Calif., incurred extensive damage as a result of the Camp Fire. The fire also damaged or destroyed almost all of the homes and businesses in Paradise. Feather River remains closed, and Adventist Health has not yet set a timeline for the reestablishment of acute-care services in this market. Although there is little Adventist Health can do to mitigate the risk of wildfires, in our opinion, the centralization of the system's administration and management allows for allocation of resources and functions to respond and adapt to disruptive environmental events, and somewhat offsets financial risks.

We view Adventist Health's governance and social risks as being in line with those of industry peers. However, the core mission of health care facilities is protecting the health and safety of communities, which is further evidenced by responsibilities to serve the surge in patient demand with COVID-19. We believe the pandemic exposes the sector to additional social risks that could present financial pressure in the short term, particularly if federal and state support are insufficient to cover the decreased revenue resulting from sharp admission and surgical volume declines required to preserve capacity, supplies, and equipment, and to maintain appropriate levels of staffing.

Stable Outlook

Downside scenario

We could lower the rating or revise the outlook to negative if Adventist Health is unable to meaningfully improve operating margins and cash flow. We could also consider a negative rating action if key balance sheet metrics weaken from current levels, through deterioration in unrestricted reserves or a sizable debt issuance.

Upside scenario

We consider a positive rating action unlikely over the outlook period given the recent inconsistent operations and uncertainty surrounding COVID-19. Overall, we believe Adventist Health's credit profile is well suited at the 'A' rating, absent recent one-time events. Over the longer term, we could revise the outlook to positive or raise the rating if Adventist Health markedly improves its balance sheet, including days' cash on hand and cash to debt approaching medians for the 'A+' rating level, while sustaining healthy operating margins and a solid enterprise profile.

Enterprise Profile: Strong

Acquisitions and partnerships

Over the past year, Adventist Health has brought on three additional hospitals to the system through acquisition and affiliation. These include:

- Delano Regional Medical Center: As of Dec. 31, 2019, Delano Regional Medical Center, a 156-bed hospital located about 30 miles north of Bakersfield, joined Adventist Health through a membership transfer.
- Dameron Hospital: In December 2019, the system entered into an 18-month agreement to manage Dameron Hospital, a 200-bed hospital in Stockton. At the end of the management services agreement, Adventist Health will have the option to pursue a membership transfer.
- Mendocino Coast District Hospital: On March 3, 2020, voters in the Mendocino Coast Healthcare District voted to approve Adventist Health's long-term lease of Mendocino Coast District Hospital, which was closed July 1, 2020.

Since our last review, the California attorney general rejected the proposed joint operating company with Providence-St. Joseph Health System (PSJH), Sacred Trust. At this time, Adventist Health has no further plans to formally partner with PSJH, although management noted it continues to explore strategic partnerships to better serve the communities in which it operates.

Management and strategic vision

Adventist Health has experienced some turnover at the CFO position over the past two years. The system's longtime CFO retired in early 2018, and Joe Reppert was named as his permanent replacement in February 2018; however, Mr. Reppert left the system in mid-2019. Bill Wing, the president of Adventist Health, served as acting CFO in the interim, and Adventist Health named a new permanent CFO, Todd Hofheins, who started Aug. 31, 2020. Mr. Hofheins comes to Adventist Health from HealthPartners, where he served as executive vice president and CFO, and prior to that as executive vice president and CFO at PSJH. Despite turnover in the CFO role, the Adventist Health management team is otherwise stable.

Over the past several years, Adventist Health has been guided by its One Adventist Health strategic plan. The plan prioritized business transformation, as the system continues to centralize operations and operate more efficiently

under a shared-service model. In our view, this structure lends increased flexibility and streamlined decision-making. As part of these efforts, Adventist Health also centralized certain administrative functions, including supply chain, human resources, accounts payable, and payroll, in its efforts to leverage synergies of being a large system, and will continue to progress as a more centralized health system.

Adventist Health is now pursuing an updated strategic plan for 2030 that builds upon One Adventist Health and seeks to align the system under several key priorities. As part of its 2030 strategy, the system is reorganizing the leadership structure under four key strategic priorities: consumer, health management, care delivery, and well-being. Over the next several years, Adventist plans to invest in growth strategies beyond the acute-care setting to diversify operations, which we view favorably.

Table 1

Adventist Health System-West -- Enterprise Statistics				
	--Six months ended June 30--		--Fiscal year ended Dec. 31--	
	2020	2019	2018	2017
Inpatient admissions	56,011	123,443	123,392	119,269
Equivalent inpatient admissions	111,582	256,945	257,106	219,977
Emergency visits	327,252	757,362	724,563	676,387
Inpatient surgeries	10,892	25,892	27,002	26,757
Outpatient surgeries	20,590	51,363	53,195	54,393
Medicare case mix index	1.7800	1.7200	1.7200	1.6400
FTE employees	19,190	18,893	18,831	19,007
Active physicians	7,086	6,649	5,999	5,594
Based on net/gross revenues	Net	Net	Net	Net
Medicare (%)	35.8	35.0	33.6	35.6
Medicaid (%)	31.4	31.7	28.9	33.5
Commercial/Blues (%)	28.7	29.8	31.6	27.5

N/A--Not applicable. N.A.--Not available. Inpatient admissions exclude normal newborn, psychiatric, rehabilitation, and long-term care facility admissions.

Financial Profile: Strong

Continued strain on operations expected to improve throughout the fiscal year

Adventist Health's operating results have been weak over the past 18 months (ended June 30, 2020), following several years of improvement. In fiscal 2019, Adventist Health experienced significant challenges with its revenue cycle, although management has indicated that most of these issues have been resolved with the engagement of a consulting firm, Huron, to run the revenue cycle and employ all revenue cycle leadership. The system reached an agreement with Cerner to backstop certain uncollectible aged accounts, which should limit the impact on the revenue cycle. Although the revenue cycle issues have largely been resolved, the six-month interim period ended June 30, 2020, experienced significant stress due to COVID-19. Following the cessation of non-emergent procedures in mid-March, the system experienced significant utilization declines, with overall admissions in April down more than 30% from the previous year. Although May and June saw solid improvement, admissions remain lower than prior-year levels. From

discussions with management, July admissions continued to improve ahead of expectations, and we expect volumes will gradually recover through the remainder of the fiscal year.

As previously noted, Adventist Health received \$218 million in CARES Act funding through June 30, 2020, with an additional \$67 million received in July, which should contribute to stabilizing operations through the remainder of the fiscal year. The system is also in the process of applying for Federal Emergency Management Agency reimbursement of COVID-19-related expenses, which could further stabilize operations. The system is also expecting a higher net benefit from California's quality assurance fee program for fiscal 2020, projecting \$259 million, up from \$244 million in fiscal 2019. We expect operations will gradually improve through fiscal 2020 as volumes continue to recover, contributing to solid cash flow and MADS coverage. We do note, however, there remains significant uncertainty surrounding COVID-19 and further operational stress could negatively pressure the rating.

Solid balance sheet lends near-term stability to the rating

Adventist Health has generally maintained its liquidity and debt metrics, even though capital spending has consistently been above depreciation levels for the past several years. While cash to debt remains somewhat weak, operational liquidity is comfortably above medians for the rating level, which we view favorably. Management's projections call for approximately \$2.2 billion in capital and strategic investments from fiscal 2021 through fiscal 2025, funded with operating cash flow and debt issuance, although management has indicated that various capital projects are potentially on hold or delayed due to COVID-19. Management's goal is to improve the balance sheet to reach and sustain 195 days' cash on hand and about 1.1x unrestricted reserves to debt at the end of this capital spending model. Management will adjust spending as necessary to continue building overall balance sheet strength, which should be further supported by the shift in focus from growth in the 2030 strategy. The balance sheet is further supported by the CARES funding received, as well as \$358 million in Medicare Advance Payments (excluded from unrestricted reserves).

No material debt issuance is expected over the outlook period, although Adventist Health is evaluating potential refinancing options and short-term financing. While the system's leverage is elevated compared with medians for the rating level, Adventist Health does not have a defined benefit pension plan and is not party to any swap agreements. The system also maintains low exposure to contingent liabilities, with an extremely healthy reserves-to-contingent-liabilities ratio.

Table 2

	Adventist Health System-West -- Financial Statistics				--Medians for 'A' rated health care system--
	--Six months ended June 30--	--Fiscal year ended Dec. 31--			
	2020	2019	2018	2017	2019
Financial performance					
Net patient revenue (\$000s)	1,937,000	4,123,000	3,994,000	3,724,405	2,811,264
Total operating revenue (\$000s)	2,320,000	4,481,000	4,409,000	4,078,185	2,920,867
Total operating expenses (\$000s)	2,350,000	4,632,000	4,317,000	3,910,573	MNR
Operating income (\$000s)	(30,000)	(151,000)	92,000	167,612	MNR
Operating margin (%)	(1.29)	(3.37)	2.09	4.11	1.80
Net nonoperating income (\$000s)	25,000	89,000	53,000	62,172	MNR

Table 2

	--Six months ended June 30--		--Fiscal year ended Dec. 31--		--Medians for 'A' rated health care system--
	2020	2019	2018	2017	2019
Excess income (\$000s)	(5,000)	(62,000)	145,000	229,784	MNR
Excess margin (%)	(0.21)	(1.36)	3.25	5.55	3.50
Operating EBIDA margin (%)	4.44	2.39	7.46	9.26	5.90
EBIDA margin (%)	5.46	4.29	8.56	10.63	9.00
Net available for debt service (\$000s)	128,000	196,000	382,000	439,959	285,841
Maximum annual debt service (\$000s)	114,876	114,876	114,876	114,876	MNR
Maximum annual debt service coverage (x)	2.23	1.71	3.33	3.83	3.70
Operating lease-adjusted coverage (x)	1.92	1.55	2.57	2.96	3.10
Liquidity and financial flexibility					
Unrestricted reserves (\$000s)	2,087,000	2,115,000	2,010,000	1,769,946	1,462,285
Unrestricted days' cash on hand	169.2	173.9	177.5	172.5	160.60
Unrestricted reserves/total long-term debt (%)	99.2	100.0	97.0	101.2	136.10
Unrestricted reserves/contingent liabilities (%)	4,312.0	4,369.8	820.8	702.2	531.60
Average age of plant (years)	11.8	11.7	11.4	11.6	11.80
Capital expenditures/depreciation and amortization (%)	87.9	95.8	118.0	128.4	134.60
Debt and liabilities					
Total long-term debt (\$000s)	2,104,000	2,114,000	2,073,000	1,749,655	MNR
Long-term debt/capitalization (%)	41.7	41.9	43.0	43.7	38.80
Contingent liabilities (\$000s)	48,400	48,400	244,875	252,040	MNR
Contingent liabilities/total long-term debt (%)	2.3	2.3	11.8	14.4	25.70
Debt burden (%)	2.45	2.51	2.57	2.77	2.30
Defined-benefit plan funded status (%)	N/A	N/A	N/A	N/A	75.90
Miscellaneous					
Medicare advance payments (\$000s)*	358,000	N/A	N/A	N/A	MNR
Short-term borrowings (\$000s)*	N/A	N/A	198,630	N/A	MNR
CARES Act grants recognized (\$000s)	218,000	N/A	N/A	N/A	MNR
Total net special funding (\$000s)	173,369	349,562	336,343	417,285	MNR

*Excluded from unrestricted reserves, long-term debt, and contingent liabilities. N.A.--Not available. N/A--Not applicable. MNR--Median not reported.

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

Credit Snapshot

- Credit overview: Adventist Health operates 22 hospitals. Although most are in three distinct markets in California, the system also has facilities in Oregon, Washington, and Hawaii, which demonstrates Adventist's good geographic and revenue diversity. Adventist Health derives about one-third of its revenue in central California and approximately one-quarter of its revenues in each of northern and southern California, with the remaining revenues coming from markets in Oregon, Washington, and Hawaii combined. The hospitals range from large tertiary providers to smaller community hospitals with fewer than 50 beds. Supporting the acute-care operations are home-care and hospice agencies, and both wholly owned and joint-venture retirement centers.
- Security pledge: The revenues of the obligated group secure Adventist Health's bonds.
- Group rating methodology: Core

Ratings Detail (As Of September 15, 2020)

Adventist Hlth Sys/West (Adventist Hlth Sys/West) SYSTEM

<i>Long Term Rating</i>	A/Stable	Affirmed
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California Hlth Facs Fincg Auth, California

Adventist Hlth Sys/West, California

California Hlth Facs Fincg Auth (Adventist Hlth Sys/West) JOINTCRIT

<i>Long Term Rating</i>	AA/A-1+	Affirmed
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<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
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California Hlth Facs Fincg Auth (Adventist Hlth Sys/West) Revenue Bonds

<i>Long Term Rating</i>	A/Stable	Affirmed
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California Statewide Communities Dev Auth, California

Adventist Hlth Sys/West, California

California Statewide Communities Development Authority (Adventist Health System/West) (ASSURED GTY)

<i>Unenhanced Rating</i>	A(SPUR)/Stable	Affirmed
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California Statewide Comntys Development Authority (Adventist Health System/West)

<i>Long Term Rating</i>	A/Stable	Affirmed
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Multnomah Cnty Hosp Facs Auth, Oregon

Adventist Hlth Sys/West, California

Hospital Facilities Authority of Multnomah County (Adventist Health System/West)

<i>Long Term Rating</i>	A/Stable	Affirmed
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Many issues are enhanced by bond insurance.

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