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Ratings

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

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Table Of Contents

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

Credit Profile		
Adventist Hlth Sys/West taxable comm pap nts ser 2020A dtd 11/02/2020		
Short Term Rating	A-1	Affirmed
California Hlth Facs Fincg Auth, California		
Adventist Hlth Sys/West, California		
California Health Facilities Finance Authority (Adventist Health System/West)		
Long Term Rating	A/Negative	Affirmed

Rating Action

S&P Global Ratings revised the outlook to negative from stable and affirmed its 'A' long-term rating and underlying rating (SPUR) on debt issued by various entities for Adventist Health System/West, Calif. (Adventist Health).

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.

In addition, we affirmed our 'A-1' short-term rating on Adventist Health's $150 million series 2020A taxable commercial paper (CP) notes. We base our rating on the series 2020A notes on self-liquidity provided by Adventist Health. S&P Global Ratings monitors Adventist Health's liquidity monthly to ensure it is sufficient to support the proposed CP issuance and its other self-liquidity obligations, if needed. Adventist Health plans to use the CP, as necessary, for temporary liquidity needs.

Credit overview

The outlook revision reflects a multiyear trend of negative operating performance that has pressured the financial profile. Financial performance since fiscal 2019 has been heavily affected by one-time or short-term impacts including revenue cycle challenges, wildfires, and the COVID-19 pandemic. While we recognize these events are one-time in nature, we could lower the rating if meaningful improvement is not demonstrated during the outlook period. Precluding a downgrade at this time is Adventist Health's historical operating strength prior to fiscal 2019, indicating a solid run rate can be achieved, as well as the system's largescale improvement plan being implemented during the outlook period. In addition, despite the negative operating performance, the system's balance sheet continues to improve, lending some flexibility at the rating level.

The rating reflects our view of Adventist Health's sizable geographic and revenue diversity, with 23 hospitals operating across three states, as well as management's efforts over the past several years to more tightly align the system's hospitals. We view Adventist Health's movement to centralization and integration positively, as it has historically helped the system through periods of operating volatility. We also view Adventist Health's management favorably, as the system has laid out a dynamic strategic vision with clear goals and benchmarks for the executive team.

The rating also incorporates our view of Adventist Health's financial profile, highlighted by volatile operations, and our view of the system's improving balance sheet. Adventist Health's operating margin has weakened over the past two fiscal years and through the six-month interim period ended June 30, 2021; however, these periods were heavily affected by one-time events. Fiscal 2019 saw a sizable operating loss 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. Fiscal 2020 and the six-month interim period ended June 30, 2021 were significantly affected by the COVID-19 pandemic and the Glass Fire in September 2020 that forced the closure of one of Adventist Health's facilities for more than two months. In response to these operating challenges, Adventist Health is executing a $300 million improvement plan over the next two years to stabilize operations and return to historical profitability. In addition, Adventist Health expects to receive further relief funds from Federal Emergency Management Agency (FEMA) reimbursement related to the pandemic, which should help stabilize operations. We expect operations will improve during the outlook period given the improvement plan and stabilization in COVID-19-related impacts; however, if meaningful improvement is not demonstrated during the outlook period, we could lower the rating. Furthermore, while coverage is weak through the interim period, we do not expect a covenant violation in fiscal 2021 given the debt service coverage through June 30, 2021 as calculated by the master trust indenture is in line with the covenant level.

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

- Operating size and scale, with 23 hospitals in three western states, and diversification in urban, rural, and suburban markets;
- Improving operating liquidity, as measured by days' cash on hand and unrestricted reserves to long-term debt; 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:

- Multiyear trend of negative operations, contributing to modest maximum annual debt service (MADS) coverage, although management is executing a largescale improvement plan;
- Elevated debt levels with high leverage and low unrestricted reserves to long-term debt, although these have shown solid improvement; 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 (ESG) 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. Adventist Health was also heavily affected by the Glass Fire in September 2020, which forced the evacuation and closure of the St. Helena facility for more than two months. 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. We view Adventist Health as being reliant on special funding for operations, which we view as higher risk given potential for changes at the state and federal level. We also believe the pandemic exposes Adventist Health and the entire sector to additional social risks that, although improving given widespread vaccine distribution, remain a threat and point of uncertainty, particularly with the spread of COVID-19 variants and potential increased labor costs.

Negative Outlook

Downside scenario

We could lower the rating if Adventist Health is unable to meaningfully and sustainably 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.

Return to stable scenario

We could revise the outlook to stable during the outlook period if Adventist Health shows a trend of operating improvement, generating strong cash flow and MADS coverage approaching 'A' rating levels. We would also view positively continued balance sheet improvement and maintenance or improvement of the enterprise profile.

Credit Opinion

Enterprise Profile: Strong

Market leadership across multiple markets

Adventist Health serves multiple distinct markets across four states, although the majority of operations are concentrated in California. The system is composed of 23 hospitals and has held the leading market share in each of its key markets, including Northern, Central, and Southern California, as well as the Pacific Northwest. Recent additions to the system include:

- Dameron Hospital: In December 2019, Adventist Health entered into an 18-month management services agreement, which was extended through March 31, 2022, with the 200-bed Dameron Hospital in Stockton, Calif., expanding the footprint and reach of the system's Lodi Hospital. As part of the agreement, once the agreement is concluded, Adventist Health could pursue a membership transfer.
- Mendocino Coast Healthcare District: As of July 1, 2020, Adventist Health commenced a long-term lease agreement with Mendocino Coast Healthcare District, which operates a 25-bed critical-access hospital. The hospital

is branded as Adventist Health Mendocino Coast and expands the system's patient reach in Mendocino County.

Management said there are no plans at this time to bring additional hospitals into the system. However, the system has continuous discussions with many providers on ways to best serve the markets in which they operate. As part of its broader strategic vision, the system is also investing in its health division, which focuses on payer partnerships, network development, management services, and employee health plan. In addition, Adventist Health has also grown its well-being division through the acquisition of Blue Zones in early 2020 and other investments to focus on individual and community well-being.

Management and strategic vision

Adventist Health has experienced some turnover at the CFO position during the past few years, with the current CFO, Todd Hofheins, starting Aug. 31, 2020. Mr. Hofheins came 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 Providence St. Joseph Health. Management said the transition has been smooth. There is turnover expected as well at the CEO level with Scott Reiner planning to leave the organization at the end of 2021. We understand the management team and board are planning extensively for the succession and we expect a smooth transition.

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 increases flexibility and streamlines decision-making. As part of these efforts, Adventist Health also centralized most 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 three key divisions: care, health, and well-being. Over the next several years, Adventist plans to invest in growth strategies beyond the acute-care setting to diversify operations through investment in the health and well-being divisions. We view the system's strategic planning favorably, as the vision should help diversify the system's revenue sources and operate as an integrated health care system.

Table 1

Adventist Health System-West, California -- Enterprise Statistics

	--Six months ended June 30--	--Fiscal year ended Dec. 31--		
	2021	2020	2019	2018
PSA population	N.A.	N.A.	N.A.	N.A.
PSA market share (%)	N.A.	N.A.	N.A.	N.A.
Inpatient admissions	56,569	112,719	123,443	123,392
Equivalent inpatient admissions	114,999	223,737	256,945	257,106
Emergency visits	312,748	638,221	757,362	724,563
Inpatient surgeries	11,216	21,950	25,892	27,002
Outpatient surgeries	24,772	44,382	51,363	53,195
Medicare case mix index	1.8600	1.8100	1.7200	1.7200

Table 1

Adventist Health System-West, California -- Enterprise Statistics (cont.)

	--Six months ended June 30--	--Fiscal year ended Dec. 31--		
	2021	**2020**	**2019**	**2018**
FTE employees	19,334	19,060	18,893	18,831
Active physicians	7,301	7,355	6,649	5,999
Top 10 physicians admissions (%)	N/A	N/A	N/A	N/A
Based on net/gross revenues	Net	Net	Net	Net
Medicare (%)	37.4	35.7	35.0	33.6
Medicaid (%)	29.1	30.9	31.7	28.9
Commercial/Blues (%)	29.8	28.0	29.8	31.6

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 operational strain expected to ease during outlook period with extensive improvement plan

Adventist Health's operating results have been compressed since fiscal 2019, generating consistently negative operating margins. In fiscal 2019, Adventist Health experienced significant challenges with its revenue cycle, although management said 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 limited the impact on the revenue cycle. Although the revenue cycle issues have largely been resolved, fiscal 2020 and the six-month interim period ended June 30, 2021, experienced significant stress due to COVID-19 and the impacts of the Glass Fire closing one of the system's facilities for two months at the end of 2020. To address the ongoing negative margins, Adventist Health is targeting $300 million in EBIDA improvements during the outlook period, including revenue cycle improvements, labor and productivity initiatives, and reduction of COVID-19 related expenses.

Providing some stability to operations throughout the pandemic, Adventist Health received $308 million in provider relief funding, recognizing $288 million in fiscal 2020 and $20 million through the six-month interim period ended June 30, 2021. The system is also applying for FEMA reimbursement of COVID-19-related expenses, which could further stabilize operations. We expect operations will gradually improve although likely remain negative through fiscal 2021, with adequate cash flow and MADS coverage. Furthermore, we expect Adventist Health will meaningfully improve operations during the outlook period as volumes continue to rebound, COVID-19-related impacts lessen, and the planned operating improvements are implemented. However, continued negative operations could lead to a downgrade.

Improving balance sheet lends near-term stability to the rating

Adventist Health has seen incremental growth in unrestricted reserves over the past several years with steady cash flow despite negative operating margins and limited capital spending. While cash to debt remains somewhat weak compared with median levels, the metric has been solidly above 1x for a sustained period, which we view favorably. In addition, operational liquidity as measured by days' cash on hand is well in line with medians for the rating level. We expect continued growth in the balance sheet, as capital spending is expected to remain modest while the system focuses on stabilizing operations and increasing cash flow. Management's goal is to improve the balance sheet to reach and sustain more than 200 day's cash on hand and almost 1.5x unrestricted reserves to debt over the next five years. The balance sheet is further supported by the CARES Act funding received, as well as $315 million in Medicare Advance Payments as of June 30, 2021, which we exclude from our calculation of unrestricted reserves.

No material debt issuance is expected over the outlook period. Although 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. As of fiscal 2020 and through the six-month interim period ended June 30, 2021, Adventist Health had $60 million of CP outstanding, which we consider to be contingent, but does not have a material impact on contingent liability metrics. Therefore, we view Adventist Health's debt profile as appropriately conservative.

Table 2

Adventist Health System-West, California -- Financial Statistics

	--Six months ended June 30--	--Fiscal year ended Dec. 31--			--Medians for 'A' rated health care system--	--Medians for 'A-' rated health care system--
	2021	2020	2019	2018	2020	2020
Financial performance						
Net patient revenue ($000s)	2,253,000	4,097,000	4,123,000	3,994,000	2,687,606	2,076,521
Total operating revenue ($000s)	2,454,000	4,730,000	4,481,000	4,409,000	3,065,105	2,684,250
Total operating expenses ($000s)	2,573,000	4,848,000	4,632,000	4,317,000	MNR	MNR
Operating income ($000s)	(119,000)	(118,000)	(151,000)	92,000	MNR	MNR
Operating margin (%)	(4.85)	(2.49)	(3.37)	2.09	0.70	0.60
Net nonoperating income ($000s)	49,000	87,000	89,000	53,000	MNR	MNR
Excess income ($000s)	(70,000)	(31,000)	(62,000)	145,000	MNR	MNR
Excess margin (%)	(2.80)	(0.64)	(1.36)	3.25	2.30	2.40
Operating EBIDA margin (%)	0.45	3.19	2.39	7.46	6.60	6.70
EBIDA margin (%)	2.40	4.94	4.29	8.56	8.00	8.00
Net available for debt service ($000s)	60,000	238,000	196,000	382,000	253,176	209,691
Maximum annual debt service ($000s)	111,867	111,867	111,867	111,867	MNR	MNR
Maximum annual debt service coverage (x)	1.07	2.13	1.75	3.41	3.60	3.30
Operating lease-adjusted coverage (x)	1.05	1.85	1.58	2.62	2.80	2.60
Liquidity and financial flexibility						
Unrestricted reserves ($000s)	2,357,000	2,148,000	2,115,000	2,010,000	1,653,752	1,287,932
Unrestricted days' cash on hand	173.7	168.7	173.9	177.5	177.60	205.80
Unrestricted reserves/total long-term debt (%)	117.5	105.5	100.0	97.0	143.60	112.60

Table 2

Adventist Health System-West, California -- Financial Statistics (cont.)

	--Six months ended June 30--	--Fiscal year ended Dec. 31--			--Medians for 'A' rated health care system--	--Medians for 'A-' rated health care system--
	2021	2020	2019	2018	2020	2020
Unrestricted reserves/contingent liabilities (%)	2,213.1	2,016.9	4,369.8	820.8	580.20	456.20
Average age of plant (years)	12.7	12.0	11.7	11.4	11.60	12.00
Capital expenditures/depreciation and amortization (%)	63.9	83.1	95.8	118.0	117.30	108.30
Debt and liabilities						
Total long-term debt ($000s)	2,006,000	2,036,000	2,114,000	2,073,000	MNR	MNR
Long-term debt/capitalization (%)	39.6	40.0	41.9	43.0	39.50	44.70
Contingent liabilities ($000s)	106,500	106,500	48,400	244,875	MNR	MNR
Contingent liabilities/total long-term debt (%)	5.3	5.2	2.3	11.8	26.40	25.20
Debt burden (%)	2.23	2.32	2.45	2.51	2.40	2.40
Defined-benefit plan funded status (%)	N/A	N/A	N/A	N/A	73.10	85.10
Miscellaneous						
Medicare advance payments ($000s)*	315,000	358,000	N/A	N/A	MNR	MNR
Short-term borrowings ($000s)*	0	0	0	0	MNR	MNR
CARES Act grants recognized ($000s)	20,000	288,000	N/A	N/A	MNR	MNR
Total net special funding ($000s)	180,000	363,000	349,562	336,343	MNR	MNR

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

Credit Snapshot

- Security pledge: The revenues of the obligated group secure Adventist Health's bonds.
- Group rating methodology: Core
- Credit overview: Adventist Health operates 23 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.

Related Research

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

Ratings Detail (As Of October 7, 2021)		
Adventist Hlth Sys/West (Adventist Hlth Sys/West) SYSTEM		
Long Term Rating	A/Negative	Affirmed
California Hlth Facs Fincg Auth, California		
Adventist Hlth Sys/West, California		
California Hlth Facs Fincg Auth (Adventist Hlth Sys/West) JOINTCRIT		
Long Term Rating	AA/A-1+	Affirmed
Unenhanced Rating	A(SPUR)/Negative	Affirmed
California Hlth Facs Fincg Auth (Adventist Hlth Sys/West) Revenue Bonds		
Long Term Rating	A/Negative	Affirmed
California Statewide Communities Dev Auth, California		
Adventist Hlth Sys/West, California		
California Statewide Communities Development Authority (Adventist Health System/West) (ASSURED GTY)		
Unenhanced Rating	A(SPUR)/Negative	Affirmed
California Statewide Comntys Development Authority (Adventist Health System/West)		
Long Term Rating	A/Negative	Affirmed
Multnomah Cnty Hosp Facs Auth, Oregon		
Adventist Hlth Sys/West, California		
Hospital Facilities Authority of Multnomah County (Adventist Health System/West)		
Long Term Rating	A/Negative	Affirmed

Many issues are enhanced by bond insurance.