S&P Global Ratings

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Stanford Health Care, California California Health Facilities Financing Authority; CP; Hospital; System

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Stanford Health Care, California
California Health Facilities Financing Authority; CP; Hospital; System

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California Health Facilities Financing Authority, California		
Stanford Health Care, California		
California Health Facilities Finance Authority (Stanford Hlth Care)		
Long Term Rating	AA-/A-1+/Positive	Outlook Revised

Credit Highlights

- S&P Global Ratings revised the outlook, where applicable, to positive from stable and affirmed its 'AA-' long-term rating on the California Health Facilities Financing Authority's various tax-exempt and taxable revenue bonds issued for Stanford Health Care (SHC; f/k/a Stanford Hospitals & Clinics).
- S&P Global Ratings' also affirmed its 'A-1+' short-term rating on SHC's $150 million taxable and $200 million tax-exempt commercial paper (CP) programs, and its 'AA-/A-1+' dual rating on various bonds in weekly and CP mode issued for SHC. We base our 'A-1+' short-term rating component on the dual ratings, and our short-term ratings on our view of SHC's own liquidity and procedures for handling potential tenders.
- The outlook revision is based on continued strong financial and enterprise profiles, highlighted by a consistency of positive and sound operating performance even during the pandemic.

Security

Gross receivables, including receivables from hospital-based services and outpatient clinics, secure the bonds.

Credit overview

The ratings reflect our assessment of SHC's strengthening demand as one of the two main academic medical centers in the populated Bay Area region with comprehensive services focused on tertiary and quaternary business mix, exceptionally high case mix index, and brand strength in a generally competitive market. A focus on partnerships, including that with Sutter Health in oncology services, and expanded services at its East Bay location in Alameda County (Stanford Health Care Tri-Valley), and most recently, an upcoming lease of a 24-bed unit at nearby Sequoia Hospital in Redwood City, should further augment its business position.

In addition, a close relationship with Stanford University; a large, well-regarded, and well-distributed academic and medical faculty and a growing group of community-based physicians through its medical foundation (University HealthCare Alliance, d/b/a Stanford Medicine Partners); and solid research funding at Stanford University support SHC's position in the market. Other credit strengths are a solid fundraising program and SHC's location in Silicon Valley, a favorable demographic area and home to numerous technology-related companies.

The rating incorporates our view of SHC's consistently healthy financial performance and cash flow, augmented by delivery of high-acuity volumes and a favorable payer mix and that puts it in a healthy position as it embarks on elevated capital spending for projects both on the main campus and in the surrounding areas. Debt remains moderate, while unrestricted reserves have increased following the decline from the investment markets in 2022. SHC maintains a healthy capital appetite tied to meeting increased demand as well as completing seismic upgrades. We believe its cash flow, if sustained at recent years' levels, should support that spending. We recognize that some capital spending can be slowed if needed, but that higher spending will likely continue for several years. No new-money debt is planned over the outlook period.

The rating reflects a positive adjustment for SHC's close relationship with the higher-rated Stanford University. In addition, while we make a negative adjustment to reflect a more holistic view of the credit profile and SHC's leaner balance-sheet profile (relative to peers), we could consider removing this adjustment as SHC continues to generate consistent performance and cash flow while at a minimum maintaining current days' cash on hand and further improving debt-related ratios.

The long-term rating further reflects our opinion of SHC's:

- Excellent position as a premier academic medical center with a strong academic partner highlighted by high occupancy and a comprehensive tertiary and quaternary mix of services as reflected in a very high Medicare case mix index;
- History of solid cash flow and positive operating margins (except for fiscal 2020) that we expect will continue;
- Generally stable days' cash on hand over a longer period with increasing unrestricted reserves, which, along with healthy cash flow, should be able to support ongoing capital spending plans;
- Sound strategy of expanding its overall footprint through outpatient expansion, physician recruitment, and partnerships, combined with needed inpatient renovations on the main campus to position SHC well for demand and growth; and
- Location in a favorable demographic area that is reflected in SHC's excellent payer mix, although higher cost-of-living expenses can create some challenges for staff retention and recruitment.

Partly offsetting the above strengths, in our view, are SHC's:

- Elevated capital spending expected for a number of years;
- Moderate debt levels relative to peers as a result of capital spend due to the higher patient demand and seismic upgrades;
- Dependence on investment markets to maintain reserve growth, particularly given the lighter reserves relative to medians and likely ongoing capital spending; and
- Location in a competitive service area.

Environmental, social, and governance

We view SHC's overall environmental physical risks as elevated within our credit analysis given its location in markets that have historically been prone to earthquakes and wildfires. While immediate risk to plant and facilities on the main campus are lower as a result of seismic compliance and distance from wildfire threats, we still view these environmental factors as a risk for the region given that they could affect the outpatient network as well as patient volume trends. We view SHC's social risk as neutral to our credit analysis with favorable demographic service area characteristics lowering social capital risks, but offset by higher cost-of-living and human capital risks tied to increased labor costs, access to labor, and exposure to labor unions. Unions represent approximately 30% of SHC's staff, and relationships with the union have thus far been managed adequately, although there have been limited strikes in the past. While we also view governance as neutral to our credit analysis, we look favorably on good discipline that the entire Stanford University management and governance bring to SHC, coupled with a consistent and focused strategy, use of performance metrics to track goals, and overall risk management practices.

Outlook

The positive outlook reflects our view of SHC's enterprise strengths, including its ties to Stanford University, and our expectation that SHC will continue to generate healthy cash flow given its ongoing delivery of higher-acuity services and expanded partnerships. The outlook also reflects our view of management's ability to continue to invest in capital spending while maintaining good liquidity ratios and improving debt-related metrics.

Downside scenario

A outlook revision back to stable could occur if balance-sheet ratios attenuate, there is an increase in debt, or performance metrics moderate to levels that stress funding of capital spending plans. Given the performance trends and impressive demand for services, we believe SHC has flexibility at the current rating and don't view a lower rating as likely.

Upside scenario

We believe SHC's enterprise profile is already consistent with a higher rating, and could consider an upgrade with a continued trend of healthy recuring margins and cash flow consistent with those of recent fiscal years, combined with maintaining stable days' cash on hand and generating further improvement in debt-related metrics to increase flexibility for the heightened capital spending that we believe will continue for several years.

Credit Opinion

Enterprise Profile: Very Strong

Market position sound with focus on ambulatory footprint and partnerships to support growth

SHC is in Palo Alto, with an additional inpatient facility in the East Bay (and soon, leased beds in nearby Redwood City) and a wide regional ambulatory care network, including both faculty and community (Stanford Medicine Partners) physicians. It draws patients broadly from both the immediate Santa Clara and San Mateo counties as well as from the broader region. SHC is running at very high capacity with a very high case mix index of more than 2.500. Management reports that with increased demand, the team continues to improve throughput and efficiencies to serve more patients and has been operating with a waiver above their licensed capacity. SHP's average daily census has been well over its 619 licensed beds and has hovered between 640 and 683 in 2023 and remains high through early 2024. Almost all of its volumes are up over the prior year (both inpatient and outpatient services).

Management reports that it is focused on partnerships with acute-care providers in the market as well as capital and operating investments to support growing tertiary and quaternary services from the increasing patient demand. Examples of the latter include plans to expand and integrate oncology services--a destination service line for SHC--with Sutter Health in the East Bay and expanded cardiology and orthopedic services through its faculty physicians at Stanford Health Care Tri-Valley. Volumes have historically grown but are subject to capacity constraints, which management is working to alleviate through projects, efficiencies, and partnerships.

Ties to Stanford University support the SHC credit rating

SHC is a controlled and wholly owned subsidiary of Stanford University and is adjacent to the School of Medicine (SOM). Approximately two-thirds of the medical staff are employed by and are members of the SOM faculty and account for roughly 90% of SHC's total admissions.

Considerable funds flow to and from the university, but these funds are largely for services rendered or received from the SOM. In addition, SHC transfers a sizable but generally stable sum of about $100 million annually in recent years, with a portion being variable and tied to performance over a certain threshold to support SOM's academic mission and related initiatives. The university provides other types of support to the hospital, including management of some of SHC's investments, occasional inclusion in the university's broader fundraising program, and joint-venture partnerships in certain physician-related and imaging businesses. The SOM faculty also conducts significant third-party-funded research that is included at the SOM but benefits the overall brand and referrals to SHC (research revenue is recognized by the SOM). Given its location and relationship with businesses in the area, SHC and faculty have advanced health care technology that could benefit clinical care. And more specifically, as of late, SHC and SOM faculties are taking a national leadership role in implementing and directing how artificial intelligence (AI) is used to improve care and increase efficiencies with a full governance structure to reduce data biases and limit any additional cyber-related risks.

We view SHC's management team as employing a consistent strategy that focuses on the strengths of the academic medical center and the ability to attract high-end tertiary and quaternary business from a large multicounty service area while attending to the primary care needs of the local population. The strategy focuses on innovation in care delivery and on promoting value and expanding digital and AI capabilities both for improving the patient experience and aiding the clinical care model.

Table 1

Stanford Health Care, CA -- Enterprise statistics

	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--		
	2023	2023	2022	2021
PSA population	N.A.	N.A.	7,580,000	7,700,000
PSA market share (%)	N.A.	N.A.	3.8	3.4
Inpatient admissions	10,817	43,024	39,589	37,082
Equivalent inpatient admissions	23,607	91,575	84,884	80,688
Emergency visits	37,456	147,692	133,511	118,220

Table 1

Stanford Health Care, CA -- Enterprise statistics (cont.)				
	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--		
	2023	2023	2022	2021
Inpatient surgeries	3,854	14,896	14,347	14,118
Outpatient surgeries	10,056	37,962	34,498	31,361
Medicare case mix index	2.6500	2.5600	2.5800	2.6600
FTE employees	17,444	17,153	15,841	14,911
Active physicians	3,042	2,997	2,823	2,763
Based on net/gross revenues	Net	Net	Net	Net
Medicare (%)	24.3	23.0	21.6	21.7
Medicaid (%)	10.0	7.3	7.4	6.3
Commercial/Blues (%)	63.1	65.3	66.6	69.0

Inpatient admissions exclude normal newborn, psychiatric, rehabilitation, and long-term care facility admissions. PSA--Primary service area. FTE--Full-time equivalent. N.A.--Not available.

Financial Profile: Very Strong

Healthy cash flow likely to continue, even without COVID-19-related funds

SHC's key strength is solid cash flow that has continued in recent years (and despite one-time expenses related to 2022's nurses strike), with 2023 as the first year without significant nonrecurring funds. A favorable payer mix and higher-acuity services, along with a disciplined approach to expense management, have been key contributors to performance and cash flow. As noted, we moved about $87 million of transfers to SOM into operating expenses with some of that being variable and related to SHC's performance. Excluded are transfers to SOM for capital of a net $2 million in 2023. Through the first quarter, SHC is ahead of budget and the prior year, although this is partially due to slightly higher funds from the quality assurance fee program in 2024 that are related to the prior fiscal year (about $34 million). Management anticipates that SHC will finish ahead of budget, even without the 340b settlement that was received in the second quarter.

Management has forecast operating performance at levels generally consistent with those of recent years, which we view as achievable given the level of care provided, but this will require good expense management given industry difficulties. Historically, SHC's healthy margins have depended minimally on provider tax and disproportionate share revenue.

Investment income mostly supports excess income as contributions tend to be restricted. As Stanford University manages a sizable amount of SHC's investments (about 50%), most returns will be unrealized until the investments are liquidated.

Higher capital spending likely to continue for several years, but with maintenance of steady days' cash on hand

SHC has historically balanced its unrestricted reserve growth and maintenance of liquidity-related ratios with its ongoing capital investments. Unrestricted reserves improved over 2023 due to solid cash flow and investment market gains, offset by capital spending of about $411 million in capital spending (but below a budget of just over $600 million). Capital spending will likely remain elevated for a number of years (2.0x to 3.0x) given the capacity constraints and high demand for SHC services, but management expects days' cash on hand to remain generally stable and has modeled spending to be largely supported by cash flow. Even though management has noted higher capital spend for a number of years, spending could be slower just due to project timing. Most of the projects being contemplated are discrete and spending can be managed. The main projects include renovations at 300 Pasteur (the previous main hospital next to the new tower) to be completed by 2029 and before the 2030 seismic deadline for California ($1.6 billion of which almost $500 million has been spent). In addition, other larger projects include a cancer center in partnership with Sutter Health in the East Bay (total project is $377 million of which SHC's portion is $188 million); an expanded outpatient facility in Redwood City ($711 million of which $25 million has been spent and to be completed in late fiscal 2027); and other ambulatory, routine and IT needs.

SHC's fundraising program remains a credit strength, although mostly donor restricted, and includes success through a corporate partners program with many Silicon Valley high-technology companies. SHC (in conjunction with Stanford University) is in the planning stages for its next large fundraising campaign.

Approximately half of SHC's investments reside within Stanford University's merged pool and are generally more illiquid. The remaining mix at SHC is cash and cash equivalents, fixed-income investments, and public equities. The two CP programs totaling $350 million and access to a $100 million line of credit provide additional liquidity sources.

Debt-related metrics remain moderate with slow improvement

SHC's debt increased slightly in 2024 with the debt issuance that went to reimbursement for prior capital spend. Debt should slowly decrease through principal amortization; however, we still consider most debt-related metrics weaker than those of similarly rated peers but with the smoothed debt burden very modest. Incorporated into our view of liabilities are $280 million of operating lease liabilities (or 13% of long-term debt). Excluded from debt is the taxable and tax-exempt CP availability that management does not intend to use over the next two years. The debt structure remains relatively conservative, but variable-rate demand bonds and put bonds have short- and medium-term remarketing risk and four bullet payments create some long-term risk. There are no net new additional debt plans, but management continues to monitor the most appropriate ways to finance capital needs. Management expects to refinance the upcoming $158 million put (in 2025) on its series 2021 bonds.

SHC has reduced its swap portfolio of floating- to fixed-rate swaps down to a notional amount of $338 million (versus $573 million at fiscal-year ended 2023), or about 13% of total debt outstanding, at Nov. 30, 2023. As of November 2023, SHC had no collateral posted with the mark-to-market on the swap portfolio at low $59 million liability. Its overall counterparty exposure is diversified and divided among three major institutions.

As of March 31, 2024, SHC identified $1.4 billion in discounted fixed-income and money market assets from various investments to guarantee the full and timely purchase price of $168.2 million in debt outstanding supported by self-liquidity. S&P Global Ratings monitors liquidity monthly. A range of assets made up of various investments in actively managed diversified portfolios backs the debt.

SHC terminated its pension in early 2024 (the plan was frozen in 1997 with a very small liability), and had a slightly elevated, though manageable, postretirement benefit liability of $115.6 million at fiscal year-end Aug. 31, 2023.

Table 2

Stanford Health Care, CA -- Financial statistics						
	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--			Medians for 'AA+/AA' rated stand-alone hospitals	Medians for 'AA-' rated stand-alone hospitals
	2023	2023	2022	2021	2022	2022
Financial performance						
Net patient revenue ($000s)	2,094,345	7,586,421	6,997,778	6,170,789	1,747,044	1,045,723
Total operating revenue ($000s)	2,143,181	7,871,692	7,411,492	6,771,846	2,387,171	1,120,920
Total operating expenses ($000s)	2,000,719	7,550,261	7,033,180	6,236,122	2,064,331	1,056,828
Operating income ($000s)	142,462	321,431	378,312	535,724	172,434	43,814
Operating margin (%)	6.65	4.08	5.10	7.91	7.80	3.10
Net nonoperating income ($000s)	13,099	58,863	101,998	59,129	24,137	39,540
Excess income ($000s)	155,561	380,294	480,310	594,853	236,017	85,293
Excess margin (%)	7.21	4.80	6.39	8.71	8.20	6.80
Operating EBIDA margin (%)	10.72	8.42	9.98	13.63	12.10	9.00
EBIDA margin (%)	11.26	9.10	11.21	14.38	13.00	12.90
Net available for debt service ($000s)	242,888	722,022	842,020	982,383	360,002	151,655
Maximum annual debt service ($000s)	149,859	149,859	149,859	149,859	52,086	21,669
Maximum annual debt service coverage (x)	6.48	4.82	5.62	6.56	5.40	6.60
Operating lease-adjusted coverage (x)	4.31	3.34	3.89	4.37	5.30	5.30
Liquidity and financial flexibility						
Unrestricted reserves ($000s)	5,381,128	5,184,297	4,819,738	4,916,124	1,769,902	1,031,303
Unrestricted days' cash on hand	254.0	259.7	260.1	301.7	425.8	320.8
Unrestricted reserves/total long-term debt (%)	212.4	229.7	211.6	213.4	337.8	299.7
Unrestricted reserves/contingent liabilities (%)	1,651.1	1,590.7	1,478.8	1,508.4	1,203.8	1,478.8
Average age of plant (years)	10.5	10.5	9.5	8.0	11.0	11.3
Capital expenditures/depreciation and amortization (%)	187.2	156.3	135.4	90.8	192.3	119.2
Debt and liabilities						
Total long-term debt ($000s)	2,533,866	2,256,970	2,278,272	2,303,275	798,046	296,713
Long-term debt/capitalization (%)	26.9	25.2	27.6	28.8	19.6	20.6
Contingent liabilities ($000s)	325,915	325,915	325,915	325,915	164,363	79,975
Contingent liabilities/total long-term debt (%)	12.9	14.4	14.3	14.2	21.1	19.3
Debt burden (%)	1.74	1.89	1.99	2.19	2.10	1.80
Defined benefit plan funded status (%)	N.M.	96.09	98.55	100.11	104.90	98.20
Miscellaneous						
Medicare advance payments ($000s)*	0	0	0	0	MNR	MNR

Table 2

Stanford Health Care, CA -- Financial statistics (cont.)						
	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--			Medians for 'AA+/AA' rated stand-alone hospitals	Medians for 'AA-' rated stand-alone hospitals
	2023	2023	2022	2021	2022	2022
Short-term borrowings ($000s)*	0	0	0	0	MNR	MNR
CARES Act and Other grants recognized ($000s)	0	32,031	215,316	410,467	MNR	MNR
Risk based capital ratio (%)	N/A	N/A	N/A	N/A	MNR	MNR
Total net special funding ($000s)**	73,338	72,822	60,635	21,730	MNR	MNR

N/A--Not applicable. N.M.--Not meaningful. *Excluded from unrestricted reserves, long-term debt, and contingent liabilities. **Period ended Nov. 30, 2023 includes approximately net $34 million in quality assurance fee funds for the prior year.

Credit Snapshot

- Group rating methodology: The rating is based on our view of SHC's group credit profile (i.e., the consolidated audit for the system as a whole) and the obligated group's core status within the system. Stanford University and its other wholly owned hospital subsidiary, Stanford Medicine Children's Health (also known as Lucile Salter Packard Children's Hospital at Stanford), are separately rated, as the university does not guarantee SHC's debt and as SHC and Stanford Medicine Children's Health are not co-obligated.
- Organization description: SHC is an academic medical center closely tied to Stanford University School of Medicine. SHC's sole corporate member is Stanford University, and Stanford University's board elects all of SHC's board of directors. SHC includes its main hospital campus with a 725-staffed-acute-care-bed hospital directly adjacent to Stanford University and the 160-staffed-bed Stanford Health Care -- Tri-Valley (as of November 2023). The organization also includes joint ventures with Stanford University and other entities, a medical foundation with around 300 affiliated physicians, and an insurance captive.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022

Ratings Detail (As Of April 25, 2024)		
Stanford Hlth Care rev bnds ser 2018 due 08/15/2048		
Long Term Rating	AA-/Positive	Outlook Revised
Stanford Hlth Care taxable commercial paper nts ser 2021A dtd 04/01/2021 due 10/01/2021		
Short Term Rating	A-1+	Affirmed
California Health Facilities Financing Authority, California		
Stanford Health Care, California		
California Health Facilities Finance Authority (Stanford Hlth Care)		
Long Term Rating	AA-/Positive	Outlook Revised

Ratings Detail (As Of April 25, 2024) (cont.)		
Unenhanced Rating	NR(SPUR)	
California Health Facilities Financing Authority (Stanford Health Care) cml pap rev nts (Stanford Health Care) ser 2023 due 12/01/2053		
Short Term Rating	A-1+	Affirmed
California Hlth Facs Fincg Auth (Stanford Hlth Care) rfdg hosp rev bnds (Stanford Hlth Care) ser 2008B-2 dtd 06/02/2008 rmktd dtd 06/15/2011 due 11/15		
Long Term Rating	AA-/A-1+/Positive	Outlook Revised
California Hlth Facs Fincg Auth (Stanford Hlth Care) rfdg hosp rev bnds (Stanford Hlth Care) ser 2008B-2 dtd 06/02/2008 rmktd dtd 06/15/2011 due 11/15		
Long Term Rating	AA-/A-1+/Positive	Outlook Revised