FitchRatings

Public Finance
Healthcare
U.S.A.

Stanford Health Care, California

New Issue Summary

Sale Date: Week of April 19

Series: Series 2021AB, and 2021A Taxable and 2021A Taxable CP

Purpose: Current refunding of series 2012D and 2015B bonds, and advanced refunding of series 2012A bonds, fund escrow to call date, establish taxable CP program, and pay costs of issuance.

Security: Pledge of gross revenue of the obligated group. SHC introduced an amendment to the master trust indenture (MTI) in April 2020 that purchasers of the 2021 bond offering have agreed to. The revenue pledge will be replaced by a receivables pledge once the new MTI takes effect, when majority bondholder consent is secured.

The 'AA' rating is driven by SHC's improving financial profile assessment in the context of the system's midrange revenue defensibility and resilient operations that continue to support the 'aa' operating risk profile assessment. Despite SHC's capital-related ratios that trail 'AA' rated peers, the rating reflects SHC's broad reach and clinical destination for high-acuity services, largely favorable service area characteristics and very close relationship with Stanford University, rated 'AAA'. Fitch expects SHC's operating EBITDA margins to be sustained in the long run at or above 10%; meanwhile, capital needs are expected to remain modest in the coming years as the system steadies following the peak of the coronavirus pandemic's impact in mid-2020. Strong credit characteristics are balanced by a high degree of competition in the greater San Francisco and Central Valley region. The 'F1+' rating reflects SHC's long-term credit quality, together with its ability to cover the maximum potential liquidity demands presented by its CP and weekly variable-rate demand (VRDB) programs with cash and highly liquid, highly rated investments.

Key Rating Drivers

Revenue Defensibility: 'bbb'; Solid position in competitive market with favorable demographics: SHC has midrange revenue defensibility, reflecting its solid footing as the only level 1 trauma center between San Francisco and San Jose, its expanding service line growth for higher acuity clinical services across the region, a nationally recognized brand and its position as the primary adult academic teaching hospital for Stanford University.

Operating Risk: 'aa'; Recent margin compression will improve beyond fiscal 2020: SHC has a strong operating risk profile. Following some margin compression through the height of the pandemic, operating EBITDA and EBITDA margins fell to 6.2% and 7.3%, respectively, as of fiscal YE20 (Aug. 31). A recovery through the six-month interim period ended Feb. 28, 2021 was evident as SHC generated 9.2% operating EBITDA and a 10.7% EBITDA margin (excluding $393 million in recently received Coronavirus Aid, Relief and Economic Security [CARES] Act funding that should contribute to higher YE21 results). Post-2021 performance is expected to steady around historical levels that were closer to 11% operating EBITDA. Future capital needs are currently modest given the completion of New Stanford Hospital in 2019, with spending focused on the renovation of the 300 Pasteur inpatient building and any remaining seismic needs.

Financial Profile: 'aa'; Capital-related ratios remain resilient through Fitch's scenario analysis: Total adjusted debt of $2.7 billion (which includes $371 million in operating lease and pension liabilities) is manageable against SHC's $3.9 billion in unrestricted liquidity (net of Medicare advance funds of $397 million and CARES Act-related funding of $393 million). With a 96% funded (actuarial benefit obligation, or ABO basis) defined benefit pension obligation and all operating leases reported on balance sheet ($363 million), SHC currently carries no debt equivalents.

Ratings

Long Term Issuer Default Rating	AA

New Issues

$90,315,000 California Health Facilities Financing Authority (Stanford Health Care) Revenue Bonds, Series 2021A	AA
$63,205,000 California Health Facilities Financing Authority (Stanford Health Care) Revenue Bonds, Series 2021B	AA
$150,000,000 Stanford Health Care (CA) Taxable CP Notes, Series 2021A	F1+
$365,000,000 Stanford Health Care (CA) Taxable Bonds, Series 2021A	AA

Outstanding Debt

California Health Facilities Financing Authority (Stanford Health Care) Refunding Revenue Bonds	AA
California Health Facilities Financing Authority (Stanford Health Care) Revenue Bonds	AA
California Health Facilities Financing Authority (Stanford Health Care) Variable Rate Revenue Bonds	AA
California Health Facilities Financing Authority (Stanford Hospital and Clinics) Hospital Revenue Bonds	AA/F1+
California Health Facilities Financing Authority (Stanford Hospital and Clinics) Refunding Revenue Bonds	AA
California Health Facilities Financing Authority (Stanford Hospital and Clinics) Revenue Bonds	AA
Stanford Health Care (CA) Taxable Bonds	AA

Rating Outlook

Stable

Applicable Criteria

U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (November 2020)

Public Sector, Revenue-Supported Entities Rating Criteria (February 2021)

Related Research

Fitch Rates Stanford Health Care, CA New Issue Revs 'AA'; Rating Outlook Stable (April 2021)

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Asymmetric Additional Risk Considerations

There are no asymmetric risk factors associated with SHC's rating.

Rating Sensitivities

Factors that could, individually or collectively, lead to positive rating action/upgrade:

- Given the lighter leverage metrics for the 'AA' rating, any positive rating action is unlikely at this time. Over a longer period, any positive rating movement would require meaningfully strengthened balance sheet and leverage metrics, including cash and investments approaching 200% of adjusted debt and/or net-adjusted debt to adjusted EBITDA that is consistently less than negative 3.0x.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- Fitch expects SHC to improve its operating margins after a softer fiscal 2020, eventually achieving levels similar to or better than those preceding the implementation of coronavirus restrictions. Failure to maintain operating EBIDA margins at or above 9% could result in a lower assessment of operating risk, which in turn would place pressure on the 'AA' rating.
- Weaker financial performance or significant additional borrowing that brings cash to adjusted debt to below 120% for a prolonged period could place pressure on the rating.

Credit Profile

Stanford Health Care (SHC) is a principal teaching affiliate of Stanford University's School of Medicine. SHC, together with Lucile Salter Packard Children's Hospital (rated 'AA-'), operates clinical settings through which the School of Medicine educates medical and graduate students, trains residents and clinical fellows, supports faculty and community clinicians and conducts medical and biological sciences research. SHC's close relationship with Stanford University and its School of Medicine generates certain reputational and clinical benefits that are unique in the service area and important for recruitment. SHC operates a 605 licensed-bed tertiary, quaternary and specialty hospital, as well as the primary, specialty and subspecialty clinics in which the medical faculty of the School of Medicine provide clinical services. SHC is also the sole corporate member of the 167-bed SHC ValleyCare, located in the East Bay.

The main Stanford hospital is located on the campus of Stanford University, adjacent to the School of Medicine in Palo Alto, CA.

Revenue Defensibility

SHC's payor mix is midrange, with limited exposure to Medicaid and self-pay revenues (less than 5% on a gross revenue basis). SHC's 'single signature' structure is a key element in payor negotiations, and key service lines are eligible for higher than average reimbursement given Stanford's relatively higher clinical acuity and solid outcomes. Its Stanford Health Care Alliance structure provides a very useful environment for the move to value-based reimbursement and may support more direct contracts with major employers going forward.

SHC's key markets are San Mateo and Santa Clara counties, which account for approximately 50% of its inpatient admissions. However, its geographic reach as the only level 1 trauma facility located between San Francisco and San Jose expands its reach further from Napa, south to Monterey and east to the Central Valley. As indicated by a very high case mix index (CMI) of 2.8, SHC's role as a tertiary and quaternary provider anchors its key role in the region. The nearest 'same service' competitor is University of California San Francisco Medical Center in San Francisco, and SHC continues to grow its ambulatory and physician network in its market.

SHC's service area economy is favorable, and Fitch rates the city and county of San Francisco at 'AA+' (IDR and GO). The service area benefits from the strong demographic and economic

Rating History (IDR)

Rating	Action	Outlook/ Watch	Date
AA	Affirmed	Stable	4/09/21
AA	Upgraded	Stable	7/21/14
AA-	Affirmed	Positive	7/25/13
AA-	Upgraded	Stable	5/08/08
A+	Assigned	Stable	12/16/05

characteristics within the broader region. Population growth, unemployment rates and income levels are favorable against state and national averages.

Operating Risk

The system's operating EBITDA margin has historically averaged over 10% (operating expenses include SHC's services purchased from Stanford University and the School of Medicine under its Funds Flow Agreement). Operating EBITDA weakened to 6.2% as of fiscal YE20 (Aug. 31), coinciding with the near height of pandemic impact, but has since recovered as expected to 9.2% through the six-month interim period and is expected to ultimately be maintained above 10%, in line with historical performance.

A key driver for SHC's cash flow generation is expected to be volume growth, with some evidence of that already occurring now that pandemic-related conditions have abated, coupled with a return to prior expectations of clinical and market share growth in the new facility. Ambulatory revenue grew in fiscal 2020 YoY, while surgical volumes through the six-month period ended Feb. 28, 2021 are approaching prior-year levels. SHC is focused on enhancing its destination service lines, which include cardiovascular, cancer, solid organ transplant, orthopedics and neuroscience, as well as expanding national and international distinction for these services.

Capital needs are deemed manageable and stated at $1.6 billion through 2023. Future needs are focused on a renewal project at the 300 Pasteur facility, to be funded with a combination of internal funds and philanthropy.

Financial Profile

Per Fitch's scenario analysis, SHC's leverage ratios remain consistent with the broad 'AA' rating category through year five of Fitch's forward-looking stress scenario and inclusive of the current transaction. SHC's net-adjusted debt to adjusted EBITDA was negative 1.9x, along with cash to adjusted debt of 145% as of Feb. 28, 2021. Through the cycle in the downside case scenario (which assumes an economic stress reflected as potential equity volatility in year one, followed by a recovery and then growth and stability in years three through five), net-adjusted debt to adjusted EBITDA is favorable and cash to adjusted debt remains close to 120%. These results do not include possible fundraising to offset future capital expenditures, which would further improve leverage metrics.

Total debt outstanding as of Feb. 28 2021 (quarter-end) was about $2.7 billion. SHC's debt is approximately 84% underlying fixed-rate and 16% underlying variable-rate in various modes (e.g. CP mode, weekly, etc.). The variable-rate exposure includes variable-rate demand bonds (VRDBs) supported by self-liquidity and direct purchase. This series 2021 refunding transaction is neutral to leverage, although it would add $150 million in CP authorization for future uses. On a pro forma basis, SHC's debt mix will be approximately 86% fixed rate, with 8% in a variable-rate mode and another 6% in put mode. SHC has several fixed payor swaps outstanding on a total notional amount of $575 million, with a mark-to-market value of negative $266 million as of Feb. 28, 2021, at which point SHC was posting $17.3 million in collateral.

The affirmation of the 'F1+' short-term ratings is supported by the strength of SHC's credit profile and its highly liquid resources available to fund any unremarketed puts on the $168.2 million in outstanding series 2008B1 and series 2008B-2 VRDBs. The VRDBs are in weekly and CP mode. SHC has liquidation procedures in place detailing the process by which internal funds would be liquidated to meet any tender obligations.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Financial Summary

($000, Audited Fiscal Years Ended Aug. 31)	2018	2019	2020	Six Mos. Ended 2/28/21[a]
Balance Sheet Data				
Unrestricted Cash & Investments	2,941,379	3,031,163	3,454,406	3,913,448
Total Assets	7,214,849	7,841,914	9,159,699	10,016,279
Total Debt (Including Current Portion)	1,954,672	1,935,414	2,704,027	2,689,317
Adjusted Debt	2,535,992	2,548,349	2,704,027	2,689,317
Net Adjusted Debt	(405,387)	(482,814)	(750,379)	(1,224,131)
Unrestricted Net Assets	3,304,125	3,545,875	4,193,905	4,691,668
Income & Cash Flow Data				
Net Patient Revenue	4,677,929	5,113,052	5,140,938	2,853,411
Other Revenue	232,617	276,950	426,638	156,819
Total Revenues	4,910,546	5,390,002	5,567,576	3,010,230
Depreciation & Amortization	176,742	190,283	257,725	132,315
Interest Expense	35,434	42,431	68,019	37,889
Total Expenses	4,589,887	5,006,715	5,546,532	2,904,505
Income from Operations	320,659	383,287	21,044	105,725
Operating EBITDA	532,835	616,001	346,788	275,929
Non-Operating Gains (Losses)	38,170	51,219	61,495	52,368
Excess (Deficiency) of Revenues over Expenses	358,829	434,506	82,539	158,093
EBITDA	571,005	667,220	408,283	328,297
Operating Lease Expense	116,264	122,587	0	0
Total Pension Expense	12,009	232	38	0
Adjusted EBITDA	699,278	790,039	408,321	328,297
Net Unrealized Gains (Losses)	110,984	76,748	161,720	272,723
Net Capital Expenditures	474,735	553,642	310,641	119,019
Maximum Annual Debt Service (MADS)	105,984	106,016	128,990	119,896
Liquidity Ratios				
Days Cash on Hand	243.3	229.7	238.4	257.6
Days in Accounts Receivable	48.6	48.9	46.5	46.9
Cushion Ratio (x)	27.8	28.6	26.8	32.6
MADS Coverage - EBITDA (x)	5.4	6.3	3.2	5.5
MADS Coverage - Operating EBITDA (x)	5.0	5.8	2.7	4.6
MADS / Total Revenue (%)	2.2	2.0	2.3	2.0
Profitability & Operational Ratios (%)				
Operating Margin	6.5	7.1	0.4	3.5
Operating EBITDA Margin	10.9	11.4	6.2	9.2
EBITDA Margin	11.5	12.3	7.3	10.7
Capital Related Ratios				
Cash / Debt (%)	150.5	156.6	127.8	145.5
Cash / Adjusted Debt (%)	116.0	119.0	127.8	145.5
Net Adjusted Debt / Adjusted EBITDA	(0.6)	(0.6)	(1.8)	(1.9)
Average Age of Plant (Years)	9.3	9.6	8.0	8.3
Capital Expenditures / Depreciation (%)	268.6	291.0	120.5	90.0

[a]Unaudited. EBITDA: Earnings before interest, taxes, depreciation & amortization.
Note: Unrestricted Cash excludes Medicare Advance funds in FY20 and 2Q21, and Cares Act III funds in 2Q21. Fitch may have reclassified certain financial statement items for analytical purposes.
Sources: Fitch Ratings, Fitch Solutions, Stanford Hospital and Clinics (CA)

Utilization Data (SHC Palo Alto)

(Fiscal Years Ended Aug. 31)	2018	2019	2020	Six Mos. Ended 2/28/21
Operated Beds	477	477	571	592
Acute Adult Admissions / Discharges	26,067	26,371	26,224	13,448
Acute Adult Patient Days	144,224	147,372	154,344	87,232
Average Length of Stay (Acute Days)	5.5	5.6	5.9	6.5
Average Daily Census (Acute)	395	404	422	482
Total Occupancy (%)	88	90	81	88
Observation Cases	N.A.	7,065	7,790	4,031
Hospital Stays (Admissions plus Observation Cases)	26,067	33,436	34,014	17,479
Births	1,207	0	0	0
Inpatient Surgeries	12,942	13,211	12,210	5,981
Outpatient Surgeries	24,032	24,770	22,933	12,229
Emergency Department Visits	76,115	78,650	76,688	45,597
Outpatient/Clinic Visits	805,401	864,567	893,386	670,717
Medicare Casemix Index	2.45	2.56	2.64	2.78

Sources: Fitch Ratings, Fitch Solutions, Stanford Hospital and Clinics (CA)

Payor Mix

(% Gross Revenues; Fiscal Years Ended Aug. 31)	2018	2019	2020	Six Mos. Ended 2/28/21
Medicare	35.5	35.6	35.4	33.4
Medicaid	2.9	3.1	3.3	3.7
Commercial & Managed Care[a]	55.0	55.6	56.1	57.7
Self-Pay	0.0	1.4	0.8	0.9
Other	6.6	4.4	4.4	4.3
Total	100.0	100.0	100.0	100.0

[a] Includes Medicare and Medicaid Managed care.

Sources: Fitch Ratings, Fitch Solutions, Stanford Hospital and Clinics (CA)

Key Definitions

Terms	Definition	Significance
Issuer Default Rating (IDR)	An expression of overall enterprise risk and relative vulnerability to default.	Provides an opinion of the relative ability of an entity to meet financial commitments, expressed as an ordinal measure of credit risk.
Adjusted Debt	Total long-term debt + unfunded pension liability below 80% PBO + 5.0x operating lease expense	Provides an inclusive evaluation of total long-term liabilities.
Cash to Adjusted Debt	Unrestricted cash and investments / adjusted debt	Indicates financial flexibility and cushion against decline in operating profitability.
Net Debt	Total debt – unrestricted cash and investments	Indicates the level of unrestricted liquid asset cushion available to cover debt.
Adjusted EBITDA	EBITDA + pension expense + annual operating lease expense	Provides an indication of cash flow available for the payment of debt service, adjusting for pension and operating lease obligations.
Net Adjusted Debt to Adjusted EBITDA	(Adjusted debt – unrestricted cash and investments) / adjusted EBITDA	Provides an indication of net total leverage position against available operating cash flow.
Base Case	The expected forward-looking case in the current macro-economic environment.	Provides the analytical starting point in the forward-looking analysis, and also informs the rating case.
Rating Case	The potential performance under a common set of assumptions.	Illustrates how cycles affect individual issuers differently, and informs the level of rating stability and credit resiliency.

The FAST scenario results are not a forecast. The results are intended only to illustrate performance under a given set of assumptions made by Fitch for a specific issuer that fall within the range of performance that is consistent with a stable rating. In this sense, the rating case scenario depicts a rating sensitivity and suggests the level of change in performance in stress consistent with the rating assigned. It should not be interpreted as a prediction of actual performance under stress. As an issuer can respond to a decline in portfolio value and profitability in the rating case in varied ways, actual metrics may also vary from those depicted in the scenario analysis.

Source: Fitch Ratings.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.