MOODY'S
INVESTORS SERVICE

CREDIT OPINION
31 March 2022

Send Your Feedback

Contacts

Daniel Steingart, CFA +1.949.429.5355
VP-Sr Credit Officer
daniel.steingart@moodys.com

Rita Strauss +1.212.553.3908
AVP-Analyst
rita.sverdlik@moodys.com

Stanford Health Care

Update to credit analysis

Summary

Stanford Health Care (Aa3 stable, SHC) will continue to leverage its very strong reputation and excess patient demand to maintain a very high patient census and acuity of care, and drive volume growth as it opens new facilities and establishes new programs through partnerships with regional systems. Financial performance will remain strong as a result of focus on cost control and productivity over the last several years combined with its favorable market position and high census. Balance sheet measures will likewise remain strong, though capital spending will remain elevated and will consume the majority of cash flow over the near term.

Credit strengths

» SHC is a wholly owned subsidiary of Stanford University, which will benefit from fundraising efforts and a strong working relationship with the School of Medicine and Children's Hospital

» Strong brand name and significant demand for patient care services will enable SHC to show growing volumes at the main campus and satellite locations throughout the Bay Area, particularly in higher acuity and higher reimbursing services

» Revenue growth will remain strong due to favorable contracts, high case mix index, and volume growth owing to new capacity and strong demand

» Local service area will continue to be characterized by strong wealth levels and low rates of uninsured

Credit challenges

» Capital spending will remain elevated over the next several years, consuming the majority of cash flow

» High cost of living near primary locations creates challenges for staff

» Multiple Bay Area systems pursuing growth and various insurance strategies will drive the market's competitive landscape

» Liquidity will remain modest relative to peer institutions given that over half is managed by Stanford Management Company, which requires up to six-months advance notice of withdrawal of substantial funds

Rating outlook

The stable outlook reflects expectations that strong patient demand will enable SHC to maintain favorable cash flow as it continues to spend heavily to expand patient capacity.

Factors that could lead to an upgrade

» Significant growth in cash flow translating into increased liquidity and reduced leverage

» Material growth in fundraising leading to increases in unrestricted liquidity

» Short term ratings: not applicable

Factors that could lead to a downgrade

» Sustained weakening of absolute cash flow or cash flow margin

» Continued increases in debt

» Material growth in capital spending beyond current projections that results in draw down of liquidity or material additional debt

» Short term ratings: a material reduction in coverage level of assets backing the self-liquidity program or downgrade of SHC's long term rating to A2 or lower

Key indicators

Exhibit 1

Stanford Health Care, CA

	2017	2018	2019	2020	2021
Operating Revenue ($'000)	4,408,785	4,820,828	5,296,122	5,501,117	6,726,200
3 Year Operating Revenue CAGR (%)	13.8	11.6	9.4	7.7	11.7
Operating Cash Flow Margin (%)	8.1	8.8	8.3	4.3	13.7
PM: Medicare (%)	40.4	41.4	41.8	42.6	42.1
PM: Medicaid (%)	13.3	12.7	12.8	13.1	14.0
Days Cash on Hand	209	243	227	260	304
Unrestricted Cash and Investments to Total Debt (%)	152.5	159.2	165.3	170.3	220.3
Total Debt to Cash Flow (x)	3.2	3.2	3.1	5.2	1.9

Based on audits for Stanford Health Care, fiscal year ended August 31
Transfers to Stanford University as operating expenses
Revenue and expense related to the California Provider Fee reclassified as non-operating
Swap settlement payments reclassified to interest expense Investment returns normalized at 5%
Source: Moody's Investors Service

Profile

Stanford Health Care is an academic medical center that is wholly owned subsidiary of Stanford University. It operates a hospital on the university campus in Palo Alto, one community hospital in the East Bay, and several outpatient centers throughout the Bay Area, in addition to numerous physician offices.

Detailed credit considerations

Market position: reputation will drive excess demand and enable continued growth

SHC will maintain a very strong market position driven by its status as one of two major academic medical centers in the Bay Area (and the only one in the South Bay) and its preeminent clinical reputation which is enhanced though good collaboration with Stanford University's school of medicine, a highly ranked medical school. The service area is generally favorable and characterized by high

income and wealth levels and good commercial insurance coverage. Somewhat offsetting these positive factors is the high cost of living which can be a challenge for medical staff and clinician recruitment and retention and is a contributing factor to fast growth in labor expense.

Over the next several years, we expect SHC to add capacity in several locations through new construction, renovations, and joint ventures. SHC is developing an oncology joint venture in the East Bay with Sutter Health that leverages the latter's wide community network and SHC's academic expertise and access to trials. Other key projects include additional capacity at SHC's Redwood City location and renovation of SHC's old inpatient hospital on the main campus. Capital spending has been very high for the last several years and as a result of these initiatives, will remain high for several more. We expect patient demand will continue to be very strong across a range of services, driven by SHC's very strong clinical and research reputations.

Stanford University raises significant amounts of philanthropy on an annual basis and to support specific projects or initiatives. Though SHC does not undertake significant fundraising on its own, it raised significant funds in collaboration with the university to support construction of the new hospital several years ago. Additionally, regular fundraising at the school of medicine indirectly benefits SHC through reduced pressure on the clinical system to fund research and other priorities at the school of medicine.

Operating performance, balance sheet, and capital plans: margins will remain strong; capital spending to remain high and consumer majority of cash flow

SHC's financial performance is likely to remain very strong. Because the organization has excess demand, the hospital's inpatient census is typically at or near capacity and many outpatient services have strong volume. Under the current management team, SHC has focused on operational efficiency and kept cost per adjusted discharge relatively flat for several years leading into the pandemic. Cost of living and wage inflation are likely to remain challenges given the service area, but to date, SHC has not experienced high nursing turnover, or had trouble recruiting.

Capital spending will rise significantly and could total about $3 billion over the next five years, though we note that SHC has typically underspent its capital budget. Capital will be financed through cash flow and investment returns. SHC does not anticipate issuing material new money debt over the next several years.

Liquidity

SHC currently has about $5.2 billion of unrestricted cash and about 300 days cash on hand.

Aside from approximately $2.4 billion of cash, short term bond funds, and mutual funds, investments are managed in the university's merged pool. SHC can access a portion of the funds with up to six months' notice, but given the more aggressive nature of university investments, SHC's investment profile is more similar to that of a university than a typical hospital. Moreover, liquidity is modest for the rating category and compared to peer institutions; monthly liquidity as a percentage of total cash and investments is low at approximately 50% given the large share of investments not readily accessible by the hospital.

Debt structure and legal covenants

Debt to revenue is moderate at about 32% and will continue to decline over the next several years. Moody's adjusted MADS coverage is currently very strong at over 10x and debt to cash flow is favorably low at under 2.0x; these ratios may temper slightly as operating performance is currently above historical trend, but will nonetheless remain favorable.

Legal security

The bonds are secured by a Gross Revenue pledge of Stanford Health Care and have a negative pledge subject to permitted encumbrances. SHC introduced an amendment to its MTI in the 2020 offering, which among other changes, would replace the revenue pledge with a receivables pledge once majority bondholder consent is secured. Once the amended MTI springs into effect, debt service coverage below 1.1x requires a consultant but does not trigger an event of default. There are no limitations on additional indebtedness, mergers or asset transfers.

Debt structure

Debt structure is about 85% fixed, 8% self-liquidity, and 7% put bonds. The Series 2021A has a four year put. Should SHC not be able to refinance the bonds, it has sufficient liquidity to retire them on the initial put date.

The self-liquidity program is comprised of $168 million of debt, evenly split between weekly VRDB's and VRDB's in a CP mode and a $150 million taxable CP program for cash management needs (there is no taxable CP outstanding). Weekly maturities in the CP program are limited to $50 million.

SHC staggers the rolls of VRDBs in a CP mode and keeps the two tranches at least one month apart, although we include the full $84 million in our coverage calculations. Once the taxable CP is issued, weekly maturities of CP or VRDBs in weekly mode will be limited to $134 million.

Assets supporting the program are Aaa rated 2a-7 money market funds, checking accounts at P-1 banks, US Treasuries and agency securities with maturities of two years or less, and longer dated treasuries Coverage of the program was 3.7x as of November 2022.

Debt-related derivatives

SHC has $574 million in notional swaps. The portfolio is diversified across four counterparties (JP Morgan, Wells Fargo, Goldman Sachs, and Morgan Stanley). The mark-to-market value across the entire portfolio has fluctuated significantly in recent years with liabilities across the entire portfolio often exceeding $300 million. Over the last several months, collateral posting has also ranged widely, from $0 posted to about $73 million posted with $20 million posted at the end of Q1 2022. Collateral posting is manageable given SHC's cash position.

Pensions and OPEB

SHC has a small defined benefit plan that was fully funded at FYE 2021. The plan's liabilities are relatively small (PBO of about $213 million) and the funded status has been above 92% for the last four years. Operating lease exposure is average and the comprehensive debt position (inclusive of the unfunded pension liability and operating lease debt equivalents) is manageable.

ESG considerations

Environmental

Environmental considerations are not a material credit factor. There is exposure to certain climate related risks including wildfire and smoke caused by wildfires and water stress.

Social

Social considerations are somewhat elevated. Stanford Health Care operates in high cost service area which challenges many of its employees to find affordable housing near the hospital or its outpatient locations. Exposure to government payors is not particularly high, which is a positive factor. The organization's excellent clinical and research reputations result in very strong patient demand and likely benefit medical staff recruitment, positive factors for social factors.

Governance

The hospital is wholly owned by Stanford University. As a subsidiary of the university, the hospital is able to invest in the university's merged pool, which has generated above average long term investment returns. Affiliation with the university has also benefited the hospital through better fundraising than the hospital could accomplish on its own and through collaboration on research and other projects.

REPORT NUMBER 1324170

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S
INVESTORS SERVICE