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

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Credit Profile		
Stanford Hlth Care rev bnds ser 2018 due 08/15/2048		
Long Term Rating	AA-/Stable	Current
Stanford Hlth Care taxable commercial paper nts ser 2021A dtd 04/01/2021 due 10/01/2021		
Short Term Rating	A-1+	Current
California Hlth Facs Fincg Auth, California		
Stanford Hlth Care, California		
California Health Facilities Finance Authority (Stanford Hlth Care)		
Long Term Rating	AA-/A-1+/Stable	Current
California Health Facilities Finance Authority (Stanford Hlth Care)		
Long Term Rating	AA-/Stable	Current
Unenhanced Rating	NR(SPUR)	Current
California Hlth Facs Fincg Auth (Stanford Hlth Care) hosp rev bnds (Stanford Hlth Care) ser 2010AB dtd 06/16/2010 due 11/15/2011-2021 2025 2031 2036		
Long Term Rating	AA-/Stable	Current
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+/Stable	Current
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+/Stable	Current

Rationale

S&P Global Ratings' long-term rating on the California Health Facilities Financing Authority's various tax-exempt and taxable revenue bonds issued for Stanford Health Care (SHC; formerly known as Stanford Hospitals & Clinics) is 'AA-'. In addition, S&P Global Ratings' short-term rating on SHC's $150 million commercial paper (CP) program is 'A-1+' and its dual rating on various bonds in weekly and CP mode issued for SHC is 'AA-/A-1+'.

We base our 'A-1+' short-term rating component on the dual ratings, and our short-term ratings (for the new taxable CP) on our view of SHC's own liquidity and related procedures for handling any potential tenders.

The outlook, where applicable, is stable.

Credit overview

The ratings reflect our assessment of SHC's growing business position as one of the two main academic medical centers in the largely 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, augments its position. In addition, a close relationship with Stanford University; a large, widely regarded, and well-distributed academic and medical faculty and a growing group of community-based physicians through its medical foundation (University HealthCare Alliance or UHA); and solid research funding aid these factors. With the opening of a tower in fall 2019 and service line investments both on the main campus and in the community, SHC's presence continues to grow. Other credit strengths are a solid fundraising program, favorable payer mix, and SHC's location in Silicon Valley, home of numerous technology-related companies.

The rating also incorporates an improving financial profile that puts SHC in a favorable position as it continues elevated capital spending for projects both on the main campus and in the surrounding areas. Cash flow has improved over the past year and half, partly as a result of COVID-19-related stimulus but also as a result of continued delivery of high-acuity services and a favorable payer mix that has contributed, along with healthy investment returns supported by Stanford University's investment office, to an improving balance sheet. Debt remains elevated but manageable and reflects SHC's investment in facilities, including the completion of the hospital on its main campus in Palo Alto in 2019. We expect that with the balance sheet accretion thus far and continued recovery from COVID-19, management should be able to achieve higher capital spending targets while keeping balance sheet metrics in line with the credit rating. There is no planned new money debt over the next two years.

Our rating reflects a positive adjustment for SHC's close relationship with the higher-rated Stanford University. In addition, while we take a negative adjustment to reflect a more holistic view of the credit profile and SHC's lighter financial profile (relative to medians), we could consider removing this adjustment if SHC is able to maintain balance sheet strength while sustaining healthy cash flow amid likely continued heightened capital spending over the next few years.

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

- Sound enterprise position as a premier academic medical center with a strong academic partner highlighted by historically high occupancy and a comprehensive tertiary and quaternary mix of services as reflected in a very high Medicare case mix index of 2.66 in 2021;
- Improvement in unrestricted reserves, which, along with a focus on healthy cash flow, should be able to support higher capital spending over the next few years;
- Sound strategy of expanding its overall footprint through significant outpatient expansion, physician recruitment, and partnerships, combined with needed inpatient renovations on the main campus to position SHC well for growth;
- 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; and
- Focus on expanding clinical care models and processes and improving patient experience using digital health and technology and that also incorporates its location and partnerships with businesses in the tech-focused Silicon Valley.

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

- Location in a competitive service area;
- Elevated capital spending expected for a number of years; and

- Some dependence of investment markets to maintain reserve growth, particularly given the lighter reserves relative to medians.

The stable outlook reflects our view of SHC's enterprise strengths, including its ties to Stanford University, and our expectation that SHC will meet budgeted expectations in fiscal 2022 given its ongoing delivery of higher acuity services and expanded partnerships. The outlook also reflects our view of an improved balance sheet that provides some cushion as capital spending begins to increase.

Environmental, social, and governance

We view SHC's overall environmental risks as elevated relative to those of industry peers 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 lower than that of industry peers, given its large, broad, and demographically favorable service area, though higher cost of living slightly offsets this. In addition, unions represent approximately 30% of SHC's staff. The collective bargaining agreement with the Committee of Recognition of Nursing Achievement (CRONA), representing about 3,000 employees, expires March 31, 2022. As of that date, the CRONA contract has not been finalized. Management reports that the talks could extend the contract, but also has contingency plans in place. We will monitor any financial impact or other disruption that may arise from the negotiations related to this agreement, as challenges have periodically arisen in the past (although no strikes have occurred recently). Finally, as with other providers, SHC has experienced increased social risks tied to health and safety. While vaccines and other therapeutics could ease the impact of the costs related to care, we also note uncertainty and will monitor costs and pressures arising from COVID-related care.

Stable Outlook

Upside scenario

We believe SHC's enterprise profile is consistent with a higher rating, and a positive outlook or rating action could result from consistent trend of operating margins close to forecast levels, combined with incremental improvement in balance sheet metrics to maintain adequate cushion for the heightened capital spending that we believe will continue for several years.

Downside scenario

Given the improvement to unrestricted reserves over the past couple of years and provision of higher acuity of services that are supporting cash flow, we believe SHC has cushion at the rating, but a lower rating or negative outlook could result if SHC sustains margins that are close to 2020 levels or if the higher capital spending over the next few years pressures balance sheet ratios. Although we believe SHC has capacity for additional debt, a significant issuance could strain debt-related metrics.

Credit Opinion

Enterprise Profile: Very Strong

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

SHC is centered in Palo Alto, with one additional inpatient facility in Alameda County (ValleyCare) and a wide regional ambulatory care network, including both faculty physicians (Stanford University School of Medicine, or SOM) and community physicians (UHA, a medical foundation with professional services agreements with various community physicians). SHC is running at very high capacity given the demand for both COVID-19 and non-COVID care, and SHC has continued to expand outpatient services and its reach into the community with outpatient facilities anchored in Redwood City, Emeryville (in the East Bay), and other parts of the region. Management reports that with increased demand, the team continues to improve throughput and efficiencies to serve more patients. Management reports that additional mergers are not likely and that it is focused on partnerships with acute care providers in the market as well as capital and operating investments in outpatient services to support growing tertiary and quaternary services. 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.

SHC views its service area in several ways, ranging from the large 21-county service area encompassing the broad San Francisco Bay Area to its more immediate counties of Santa Clara and San Mateo counties, where it captures 8% inpatient market share in an economically and demographically favorable service area. These various service area views demonstrate SHC's broad patient draw, reflecting its tertiary and quaternary service mix and Level 1 trauma center. Volumes have historically been growing but, as with most providers, COVID-19 dampened that in fiscal 2020. Volumes recovered in fiscal 2021 and are ahead of prior-year period results through first quarter 2022 across almost all key areas.

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 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. In addition, SHC has transferred a sizable but generally stable sum in recent years, about $100 million annually, to Stanford University to support the SOM's academic mission and related initiatives, including faculty recruitment, the academic community, and the school's physical plant. Operating and nonoperating performance include a portion of this funding, and table 2's financial performance metrics do not capture the capital payments. 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.

Stanford University and its other wholly owned hospital subsidiary, the Lucile Salter Packard Children's Hospital (also known as Stanford Children's Health), are separately rated, as the university does not guarantee SHC's debt and as

SHC and Lucile Packard Children's Hospital are not co-obligated.

Stable management team focuses on partnerships and growth

SHC's management team has been stable for several years and continues to execute on the strategic plan that was put in place a few years ago and that is yielding good recovery, with SHC having filled up the large patient tower that opened right before the beginning of the COVID-19 pandemic. The plan essentially 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 also focuses on promoting value and expanding digital capabilities both for improving the patient experience and aiding the clinical care model. Management is focused on maintaining a largely single high-end campus on the inpatient side with an eye toward partnerships in the region, including with UHA and a robust outpatient facility strategy to expand its coverage of the local market, ultimately throughout the entire San Francisco Bay Area. SHC has emphasized supporting its own faculty and their research ideas to develop digital strategies that augment and improve care.

Table 1

Stanford Health Care Utilization

	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--		
	2021	**2021**	**2020**	**2019**
PSA population - nine-county service area	N.A.	N.A.	7,750,000	7,770,000
PSA market share (%)	N.A.	N.A.	3.3	3.0
Inpatient admissions*	9,849	37,082	35,133	33,893
Equivalent inpatient admissions	21,096	80,688	76,516	76,957
Emergency visits	31,613	118,220	107,318	113,872
Inpatient surgeries	3,653	14,118	13,644	14,887
Outpatient surgeries	8,620	31,361	26,296	28,712
Medicare case mix index	2.65	2.66	2.51	2.27
FTE employees	15,144	14,911	14,816	13,542
Active physicians	2,808	2,763	2,693	3,207
Medicare (%)§	22.0	21.7	22.1	22.7
Medicaid (%)§	5.7	6.3	6.0	7.0
Commercial/Blues (%)§	68.3	69.0	68.9	67.3

*Excludes normal newborn, psychiatric, rehabilitation, and long-term care facility admissions. §Based on net revenue. FTE--Full-time equivalent. N.A.--Not available. PSA--Primary service area.

Financial Profile: Very Strong

Operating performance has rebounded in 2021 and interim 2022

SHC's operating performance has rebounded since fiscal 2020 as a result of provision of high acuity of services, COVID-related care, and good expense management. Fiscal 2021 had a significant amount of COVID-19-related stimulus, but through the first quarter of fiscal 2022 performance has remained very sound despite very little stimulus funding. While no hospital or health system is immune to the inflationary and labor expense pressures, management reports minimal labor disruptions related to recruitment and retention of staff and minimal agency usage. That said, we also note the ongoing negotiations with one of its unions noted above. As with many providers, SHC temporarily slowed certain procedural services during the height of the recent COVID-19 surge. We note that we've moved about $85 million of transfers to the SOM into operating and nonoperating expenses. (The latter is based on SHC performance.) Excluded are transfers to the SOM for capital that declined after higher amounts in recent years.

Management has forecast operating performance to approach 5%, which we view as achievable given the level of care provided, but this will require good expense management given industry headwinds. Historically, SHC experienced very healthy margins of more than 5% with growing volumes, strong revenue growth, excellent fundraising capabilities, and minimal dependence on provider tax and disproportionate share revenue.

Investment income and contributions support excess income, offset by transfer payments to the SOM that are based on SHC's operating results. These transfer payments have risen as operating results improved at SHC. Maximum annual debt service (MADS) coverage improved significantly in 2021 and interim 2022, and we expect that could decline slightly in years to come. Noncancelable operating leases have risen over time, and the gap has widened in the ratio for lease-adjusted MADS coverage relative to MADS coverage. S&P Global Ratings historically does not include unrealized gains or losses in its income calculation, and management reports that the change in value of its unrestricted cash and investments that Stanford University manages (a sizable amount) will be unrealized until the investments are liquidated.

Higher capital spending in the next few years may temper unrestricted reserve growth

Unrestricted reserves improved meaningfully through November 2022, growing about 50% since 2020 (see table 2). This growth was a result of stimulus funds and overall good cash flow, healthy investment market activity, and reduced capital spending. Reserves are reaching levels more consistent with the rating, but if cash flow doesn't hold, reserves could decline as capital spending ramps up for renovations at 300 Pasteur (the previous main hospital next to the new tower) and for other ambulatory projects. 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-rate investments, and equities.

We expect expenditures to increase again (to around $500 million to $690 million annually, or 2.5x annual depreciation, for the next few years). That said, the projects are discrete and spending could be managed if cash flow is pressured. In addition to renovations at 300 Pasteur (about $1.2 billion over the next four years), larger capital projects include a cancer center in partnership with Sutter Health in the East Bay, an expanded outpatient facility in Redwood City (about $613 million; near current outpatient facilities), and other routine and information technology 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-tech companies and other donations. As of Feb. 28, 2022, SHC raised $644 million toward its $700 million for the New Stanford Hospital, with $615 million in cash received.

Debt-related metrics remain moderate but have improved over the past year and a half

We consider most debt-related metrics slightly weaker than rating medians though improving and with smoothed debt burden in line with medians. Excluded from debt is the $150 million of taxable CP availability that management does not intend to use over the next year. The debt structure remains relatively conservative but there is short- and medium-term remarketing risk for variable-rate demand bonds and put bonds, along with four bullet payments that create some long-term risk.

In addition, SHC has a diverse but sizable swap portfolio with a notional amount of $574 million at Nov. 30, 2021, or about 25% of total debt outstanding, of floating- to fixed-rate swaps. Certain swap agreements require SHC (or the counterparties) to post collateral, based on ratings and fair market value thresholds. As of November 2021, SHC posted $20.3 million collateral, while the mark-to-market on the swap portfolio was a liability of $273 million. SHC's overall counterparty exposure has been diversified over the past few years and is now divided among four major institutions.

As of Feb. 28, 2022, SHC identified $1.4 billion in 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. The bonds in CP mode are multimodal and carry a dual rating.

SHC's pension is slightly overfunded, as the plan was frozen in 1997, but had a slightly increased though manageable postretirement benefit liability of $117 million at fiscal year-end Aug. 31, 2021.

Table 2

Stanford Health Care Financial Summary

	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--			'AA-' rated stand-alone hospital medians
	2021	2021	2020	2019	2020
Financial performance					
Net patient revenue ($000s)	1,707,090	6,170,789	5,140,938	5,113,052	881,434
Total operating revenue ($000s)	1,752,408	6,771,846	5,566,097	5,384,436	984,770
Total operating expenses ($000s)	1,617,899	6,156,397	5,582,758	5,037,241	MNR
Operating income ($000s)	134,509	615,449	(16,661)	347,195	MNR
Operating margin (%)	7.68	9.09	(0.30)	6.45	3.00
Net nonoperating income ($000s)	21,308	261	37,018	(3,602)	MNR
Excess income ($000s)	155,817	615,710	20,357	343,593	MNR
Excess margin (%)	8.78	9.09	0.36	6.39	6.20
Operating EBIDA margin (%)	12.94	14.81	5.86	11.00	8.70
EBIDA margin (%)	13.99	14.81	6.48	10.94	12.60
Net available for debt service ($000s)	248,122	1,003,240	363,327	588,833	134,766
MADS ($000s)	119,733	119,733	119,733	119,733	MNR
MADS coverage (x)	8.29	8.38	3.03	4.92	6.10
Operating-lease-adjusted coverage (x)	5.14	5.08	2.17	2.94	4.50
Liquidity and financial flexibility					
Unrestricted reserves ($000s)	5,021,508	4,916,124	3,416,123	2,903,324	906,282
Unrestricted days' cash on hand	295.9	305.8	234.2	218.6	347.7
Unrestricted reserves/total long-term debt (%)	219.1	213.4	153.5	159.4	279.5
Unrestricted reserves/contingent liabilities (%)	1,540.7	1,508.4	995.4	720.1	848.3
Average age of plant (years)	8.6	8.0	8.0	9.6	11.3
Capital expenditures/depreciation and amortization (%)	106.6	90.8	120.5	291.0	114.2

Table 2

Stanford Health Care Financial Summary (cont.)					
	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--			'AA-' rated stand-alone hospital medians
	2021	2021	2020	2019	2020
Debt and liabilities					
Total long-term debt ($000s)	2,291,656	2,303,275	2,224,863	1,821,179	MNR
Long-term debt/capitalization (%)	28.0	28.8	34.7	33.9	21.6
Contingent liabilities ($000s)	325,915	325,915	343,200	403,200	MNR
Contingent liabilities/total long-term debt (%)	14.2	14.2	15.4	22.1	40.6
Debt burden (%)	1.69	1.77	2.14	2.23	2.00
Defined benefit plan funded status (%)	N.A.	100.11	96.06	91.91	94.30
Miscellaneous					
Medicare advance payments ($000s)*	0	0	397,393	N/A	MNR
Short-term borrowings ($000s)*	N/A	N/A	N/A	N/A	MNR
Provider relief funds recognized ($000s)	4,400	393,000	123,000	N/A	MNR
FEMA and other grants ($000s)	0	17,000	12,000	N/A	MNR
Risk based capital ratio (%)	N/A	N/A	N/A	N/A	MNR
Total net special funding ($000s)	16,664	67,798	84,174	72,619	MNR

*Excluded from unrestricted reserves, long-term debt, and contingent liabilities. FEMA--Federal Emergency Management Agency. MADS--Maximum annual debt service. MNR--Median not reported. N.A.--Not available. N/A--Not applicable. Note: Unrestricted reserves in 2019 exclude a small amount of funds that were subsequently deemed to be restricted.

Credit Snapshot

- Security: Gross revenue, including patient revenue from hospital-based services along with numerous outpatient clinics, secures the bonds.
- 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. The obligated group is considered core to SHC's revenue and assets, and thus is rated at the same level as the group as a whole.
- Organization description: SHC is an academic medical center closely tied to the SOM. 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 592-staffed-acute-care-bed hospital directly adjacent to Stanford University and the 207-staffed-bed ValleyCare Health System. The organization also includes joint ventures with Stanford University and other entities, UHA 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