S&P Global
Ratings

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

Primary Credit Analyst:
Chloe A Pickett, Centennial + 1 (303) 721 4122; Chloe.Pickett@spglobal.com

Secondary Contact:
Blake C Fundingsland, Centennial + 1 (303) 721 4703; blake.fundingsland@spglobal.com

Table Of Contents

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

Credit Profile		
US$350.0 mil taxable bnds (Adventist Hlth Sys/West) ser 2022 dtd 12/15/2022 due 03/01/2053		
Long Term Rating	A-/Stable	New
US$100.0 mil CHFFA rev bnds (Adventist Health System/West) ser 2022A dtd 12/15/2022 due 03/01/2053		
Long Term Rating	A-/Stable	New
Adventist Hlth Sys/West taxable comm pap nts ser 2020A dtd 11/02/2020		
Short Term Rating	A-2	Downgraded
Adventist Hlth Sys/West (Adventist Hlth Sys/West) SYSTEM		
Long Term Rating	A-/Stable	Downgraded
California Hlth Facs Fincg Auth, California		
Adventist Hlth Sys/West, California		
California Health Facilities Finance Authority (Adventist Health System/West)		
Long Term Rating	A-/Stable	Downgraded

Credit Highlights

- S&P Global Ratings lowered its long-term rating and underlying rating (SPUR) to 'A-' from 'A' on debt issued by various entities for Adventist Health System/West, Calif. (Adventist Health).
- We also lowered the joint rating to 'AA-/A-1+' from 'AA/A-1+' 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 also lowered our short-term rating to 'A-2' from 'A-1' 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.
- S&P Global Ratings also assigned its 'A-' long-term rating to Adventist Health's $350 million series 2022 taxable bonds. At the same time, S&P Global Ratings assigned its 'A-' long-term rating to California Health Facilities Financing Authority's $100 million series 2022A tax-exempt revenue bonds, issued for Adventist Health.
- The outlook is stable.
- The lower rating 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. Although we recognize many of these events are one-time in nature, financial performance has experienced long-term deterioration, resulting in metrics no longer commensurate with the 'A' rating level.

Security

The revenues of the obligated group secure Adventist Health's bonds. Proceeds from the series 2022 taxable bonds will be used to redeem the system's line of credit, CP balance, and series 2013 bonds. Proceeds from the series 2022A tax-exempt bonds will be used for general capital purposes.

Credit overview

The rating reflects our view of Adventist Health's healthy enterprise profile, highlighted by the system's sizable geographic and revenue diversity, market leadership, and experienced management team focused on operational improvement. Adventist Health serves a large service area population of more than 14 million people, with 23 hospitals operating across three states; however, the system's core operations are in Southern, Central, and Northern California, and it generally holds a leading market share in each region. The system plans to continue expanding within its markets, largely through ambulatory and rural clinic expansion. Although the system's markets span urban, suburban, and rural regions, Adventist Health serves a somewhat vulnerable population, resulting in a heavily governmental payer mix. We view Adventist Health's improvement in centralization and integration positively, as it has historically helped the system through periods of operating volatility and enabled it to execute on strategic priorities in each region. Finally, although there has been turnover in key executive positions over the past several years, we view Adventist Health's management favorably, as the executives have extensive experience and the system has laid out a strategic vision with clear goals and benchmarks, focused on strategic growth and operational improvement.

The lower rating also incorporates our view of Adventist Health's financial profile, which has seen a multiyear trend of negative operations, somewhat stabilized by long-term improvement in balance sheet metrics. Following many years of healthy operations, Adventist Health's operating margin has been negative since fiscal 2019. Although these periods were heavily affected by one-time events, including a revenue cycle transition, wildfires, and the COVID-19 pandemic, the ongoing losses have weakened the financial profile, contributing to the lower rating. Providing some stability to the financial profile, the system has improved balance sheet metrics over the longer term, generating solid days' cash on hand and a healthy pro forma debt profile. In response to operating challenges, Adventist Health is executing an improvement plan during the outlook period, targeting more than $400 million through revenue management, labor and productivity, and administrative costs, among other areas to stabilize operations and return to historical profitability. The system is targeting incremental improvement in financial performance through fiscal year-end and during the outlook period, which we believe is reasonable considering the significant improvement plans, as well as potential recognition of additional Federal Emergency Management Agency (FEMA) funds and insurance claims related to a previous wildfire. Although operations through the nine-month interim period remain negative, the system has significantly narrowed losses through the fiscal year and expects to continue to improve financial performance through year-end. Furthermore, although pro forma coverage is weak through the interim period, we do not expect a covenant violation in fiscal 2022, given the debt service coverage through Sept. 30, 2022, as calculated by the master trust indenture is 1.5x, which is in line covenant levels.

The rating reflects our view of Adventist Health's:

- Geographic diversity and large service area population, operating 23 hospitals across three western states, with diversification in urban, rural, and suburban markets;

- Solid operating liquidity, as measured by days' cash on hand, which has improved significantly over the longer term;
- Conservative debt profile, highlighted by healthy pro forma debt burden, limited contingent-liability exposure, and no defined-benefit pension plan; and
- Improving integration and centralization of administrative process over the past several years, generating consistent operations and strategy execution.

In our opinion, offsetting credit factors precluding a higher rating include Adventist Health's:

- Multiyear trend of negative operations, resulting in weak pro forma maximum annual debt service (MADS) coverage, although management is executing a large-scale improvement plan;
- Elevated debt levels with high pro forma leverage and low pro forma unrestricted reserves to long-term debt, although these have improved;
- Rising average age of plant, although the system plans to incrementally increase capital spending during the outlook period; 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

We view Adventist Health's overall physical environmental risks as elevated in our analysis 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 neutral in our analysis, although we view Adventist Health as being reliant on special funding for operations, which we consider as higher risk given potential for changes at the state and federal level. The pandemic has exposed Adventist Health and all health care providers to additional social health and safety risks that have resulted in revenue pressure through lower volumes, and heightened expenses due to a tighter labor market and increased staffing needs; these factors will likely result in continued financial pressure in the near term.

Outlook

The stable outlook reflects Adventist Health's healthy enterprise profile and solid balance sheet, which lend near-term flexibility at the lower rating level to improve financial performance. The stable outlook also reflects preliminary indications of improving operations as the system has narrowed losses throughout the fiscal year, as well as the system's extensive improvement plan, which has been implemented and should generate operational improvement through fiscal year-end and during the outlook period.

Downside scenario

We could revise the outlook to negative or lower the rating if Adventist Health is unable to meaningfully and sustainably improve operating performance 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.

Upside scenario

Although we are unlikely to raise the rating during the outlook period, we could revise the outlook to positive if Adventist Health shows a significant trend of operating improvement, generating positive operating margins, strong cash flow, and MADS coverage approaching that of 'A' rating levels. We would also view positively balance sheet improvement and maintenance or improvement of the enterprise profile.

Credit Opinion

Enterprise Profile: Very Strong

Market leadership across multiple markets with future growth focused on ambulatory and clinic expansion

Adventist Health serves a large population of 14 million within 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. Despite the system's concentration California, Adventist Health maintains a diverse portfolio of assets, serving urban, suburban, and rural markets across the state. Although acquisitions slowed somewhat through the pandemic, the system has signed letters of intent to potentially acquire Beverly Hospital in Los Angeles, as well as Mid-Columbia Medical Center in The Dalles, Ore. Both engagements remain subject to regulatory approval and are not factored into our rating analysis at this time, but we will continue to monitor the progress and potential rating implications during the outlook period. Other expansion plans are focused on ambulatory and clinical growth, as the system has seen significant outpatient expansion in the past several years.

As the system expanded over the past several years, Adventist Health has also focused on integration and centralization within the system. Given the diverse set of assets that have been brought into the system, management has invested considerable time and resources into centralizing key corporate functions as appropriate, while still maintaining strategies applicable to each market. We view the improvement in the system's integration and centralization positively because it allows it to more easily onboard new assets, leverage Adventist Health's market leadership, and develop strategies within each market that align with the corporation's overall goals and mission.

Management and strategic vision

Adventist Health has seen turnover in several key executive roles in the past year. As expected at the time of our last review, the system's longtime CEO retired at the end of 2021, and Kerry Henrich stepped into the role in early 2022.

Mr. Heinrich comes to Adventist Health with considerable experience in the industry, having previously served as CEO at Loma Linda University Medical Center and has been on Adventist Health's board for several years. In addition to the CEO position, the previous CFO, Todd Hofheins has moved into the COO position, with John Beaman stepping into the CFO role after serving as Adventist Health's chief business officer. Despite the turnover, we believe the transition has been smooth; however, continued significant turnover that affects effectiveness or ability to execute on strategic priorities could be viewed unfavorably in our analysis.

Adventist Health's strategic plan is focused on strengthening the system's core operations, increasing market relevance, and expanding capabilities across each market. As the previous One Adventist strategic plan successfully centralized operations, the management team is building upon this to also cater strategic priorities across the system's several distinct markets. In addition, Adventist Health implemented a large operational improvement plan to enhance the system's financial performance following several years of strained operations due to one-time events and impacts from the COVID-19 pandemic. We view the management team favorably given the team's considerable experience and strategic vision, although we will continue to monitor the execution of strategic priorities and any other potential turnover during the outlook period.

Table 1

Adventist Health System-West, California--Enterprise Statistics				
	--Nine months ended Sept. 30--	--Fiscal year ended Dec. 31--		
	2022	2021	2020	2019
PSA population	N.A.	N.A.	N.A.	N.A.
PSA market share (%)	N.A.	N.A.	N.A.	N.A.
Inpatient admissions	84,773	116,381	112,719	123,443
Equivalent inpatient admissions	183,908	234,359	223,737	256,945
Emergency visits	568,428	682,364	638,221	757,362
Inpatient surgeries	16,355	22,539	21,950	25,892
Outpatient surgeries	41,203	51,327	44,382	51,363
Medicare case mix index	1.8400	1.8400	1.8100	1.7200
FTE employees	20,215	19,912	19,060	18,893
Active physicians	7,550	7,251	7,355	6,649
Based on net/gross revenues	Net	Net	Net	Net
Medicare (%)	37.6	36.2	35.7	35.0
Medicaid (%)	28.6	30.5	30.9	31.7
Commercial/Blues (%)	29.7	30.2	28.0	29.8

N.A.--Not available. Inpatient admissions exclude normal newborn, psychiatric, rehabilitation, and long-term care facility admissions.

Financial Profile: Adequate

Continued financial pressure expected to ease during outlook period with extensive improvement plan

Adventist Health's operating results have been negative since fiscal 2019, leading to modest cash flow and MADS coverage. Although the past several fiscal years have experienced largely one-time negative impacts stemming from a difficult revenue cycle transition that has largely been resolved, a wildfire heavily affecting a facility, and the pandemic, financial performance has deteriorated such that the lower rating level is appropriate. To address the ongoing negative margins, Adventist Health is targeting more than $400 million in EBIDA improvements during the outlook period, including revenue cycle improvements, labor and productivity initiatives, and reduction of administrative expenses. While there are preliminary signs of operating improvement as the system has narrowed losses through fiscal 2022, operations remain negative. Adventist Health expects to see marked improvement through fiscal year-end, which we believe is reasonable considering the recognition of additional FEMA funds and reimbursement related to the Feather River facility fire, as well as the implementation of the system's large-scale financial improvement plan. Furthermore, although MADS coverage is below 1x through the interim period as calculated by S&P Global Ratings, the debt service coverage as calculated in line with bond covenants is 1.5x through Sept. 30, 2022, which is well in line with covenant levels, so we do not anticipate any covenant violations in fiscal 2022.

We expect operations will gradually improve although likely remain negative through fiscal 2022, 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, pandemic-related impacts lessen, and the planned operating improvements are implemented. However, if the system cannot demonstrate meaningful improvement, or negative operations continue and result in balance sheet deterioration, we could revise the outlook to negative or lower the rating during the outlook period.

Solid balance sheet with minimal impact from additional debt

Unrestricted reserves have shown incremental growth over the past several years with steady cash flow despite negative operating margins and limited capital spending, although the system has seen deterioration through the nine-month interim period ended Sept. 30, 2022, due to investment market volatility. Although days' cash on hand has seen long-term improvement, pro forma unrestricted reserves-to-long-term debt is somewhat weak compared with medians for the 'A-' rating level. We expect continued growth in the balance sheet, as capital spending is forecast to remain moderate although incrementally increase while the system focuses on stabilizing operations and increasing cash flow. In addition, the system will likely receive and recognize additional FEMA funds, as well as receive additional reimbursement related to the Feather River facility fire in 2018. Adventist Health has finalized its claims with its insurer and expects to have additional clarity surrounding further settlements during the outlook period.

No material debt issuance is expected over the outlook period. Although the system's pro forma leverage is elevated, this is somewhat offset by a healthy debt burden, limited contingent-liability exposure, no defined-benefit pension plan, and no swap agreements. Contingent liabilities include the system's series 1998B and 2009B variable-rate demand bonds, series 2015 direct-purchase bonds, and $150 million CP program outstanding, although unrestricted reserves-to-contingent liabilities is excellent. Therefore, we view Adventist Health's debt profile as appropriately conservative.

Table 2

Adventist Health System-West, California--Financial Statistics					
	--Nine months ended Sept. 30--	--Fiscal year ended Dec. 31--			--Medians for 'A-' rated health care systems--
	2022	2021	2020	2019	2021
Financial performance					
Net patient revenue ($000s)	3,488,000	4,660,000	4,097,000	4,123,000	2,151,080
Total operating revenue ($000s)	3,905,000	5,164,000	4,730,000	4,481,000	2,525,214
Total operating expenses ($000s)	4,191,000	5,364,000	4,848,000	4,632,000	2,388,333
Operating income ($000s)	(286,000)	(200,000)	(118,000)	(151,000)	70,095
Operating margin (%)	(7.32)	(3.87)	(2.49)	(3.37)	1.40
Net nonoperating income ($000s)	138,000	133,000	87,000	89,000	54,300
Excess income ($000s)	(148,000)	(67,000)	(31,000)	(62,000)	86,877
Excess margin (%)	(3.66)	(1.26)	(0.64)	(1.36)	4.00
Operating EBIDA margin (%)	(2.43)	1.12	3.19	2.39	6.60
EBIDA margin (%)	1.06	3.61	4.94	4.29	10.30
Net available for debt service ($000s)	43,000	191,000	238,000	196,000	255,243
Maximum annual debt service ($000s)	139,449	139,449	139,449	139,449	74,293
Maximum annual debt service coverage (x)	0.41	1.37	1.71	1.41	4.10
Operating lease-adjusted coverage (x)	0.54	1.29	1.56	1.33	3.00
Liquidity and financial flexibility					
Unrestricted reserves ($000s)	2,064,000	2,500,000	2,148,000	2,115,000	1,476,126
Unrestricted days' cash on hand	139.5	176.5	168.7	173.9	215.8
Unrestricted reserves/total long-term debt (%)	100.0	125.0	105.5	100.0	142.6
Unrestricted reserves/contingent liabilities (%)	795.5	1,737.9	1,231.2	1,788.4	509.0
Average age of plant (years)	14.0	12.9	12.0	11.7	12.6
Capital expenditures/depreciation and amortization (%)	66.7	70.5	83.1	95.8	99.3
Debt and liabilities					
Total long-term debt ($000s)	2,064,000	2,000,000	2,036,000	2,114,000	1,204,656
Long-term debt/capitalization (%)	46.1	39.5	40.0	41.9	41.0
Contingent liabilities ($000s)	259,460	143,848	174,463	118,260	336,250
Contingent liabilities/total long-term debt (%)	12.6	7.2	8.6	5.6	27.2
Debt burden (%)	2.59	2.63	2.89	3.05	2.20
Defined-benefit plan funded status (%)	N/A	N/A	N/A	N/A	93.80
Pro forma ratios					
Unrestricted reserves ($000s)	2,064,000	N/A	N/A	N/A	MNR
Total long-term debt ($000s)	2,364,000	N/A	N/A	N/A	MNR
Unrestricted days' cash on hand	139.5	N/A	N/A	N/A	MNR
Unrestricted reserves/total long-term debt (%)	87.3	N/A	N/A	N/A	MNR
Long-term debt/capitalization (%)	49.5	N/A	N/A	N/A	MNR

Table 2

Adventist Health System-West, California--Financial Statistics (cont.)					
	--Nine months ended Sept. 30--	--Fiscal year ended Dec. 31--			--Medians for 'A-' rated health care systems--
	2022	2021	2020	2019	2021
Miscellaneous					
Medicare advance payments ($000s)*	3,000	180,000	358,000	N/A	MNR
Short-term borrowings ($000s)*	0	0	0	0	MNR
COVID-19 stimulus recognized ($000s)	111,000	126,000	295,000	N/A	MNR
Risk based capital ratio (%)	N/A	N/A	N/A	N/A	MNR
Total net special funding ($000s)	267,000	417,000	363,000	349,562	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

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

Ratings Detail (As Of November 30, 2022)		
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+	Downgraded
Unenhanced Rating	A-(SPUR)/Stable	Downgraded
California Hlth Facs Fincg Auth (Adventist Hlth Sys/West) Revenue Bonds		
Long Term Rating	A-/Stable	Downgraded
California Statewide Communities Dev Auth, California		
Adventist Hlth Sys/West, California		
California Statewide Communities Development Authority (Adventist Health System/West) (ASSURED GTY)		

Ratings Detail (As Of November 30, 2022) (cont.)		
Unenhanced Rating	A-(SPUR)/Stable	Downgraded
California Statewide Comntys Development Authority (Adventist Health System/West)		
Long Term Rating	A-/Stable	Downgraded
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-/Stable	Downgraded

Many issues are enhanced by bond insurance.