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CREDIT OPINION
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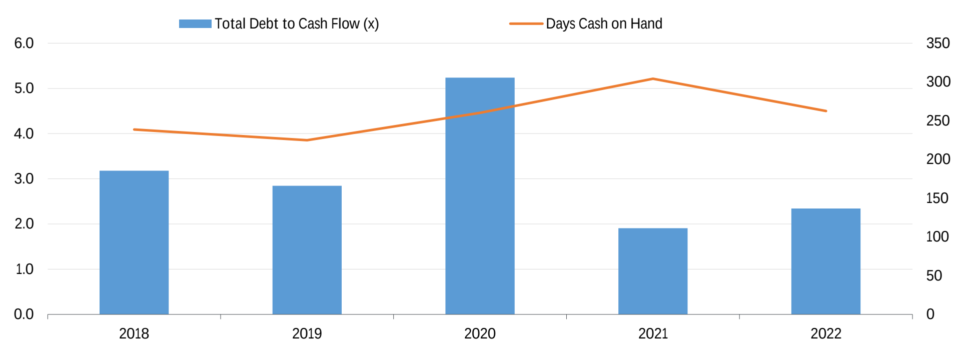
Stanford Health Care, CA

Update to credit analysis

Summary

Stanford Health Care's (Aa3 stable) credit profile is characterized by its very strong clinical reputation and position as one of two major academic medical center's in the Bay Area. Patient demand is incredibly strong and the hospital typically operates at about 100% capacity with many more patients seeking admission than it accommodate. Combined with its location in the affluent Silicon Valley, SHC's revenue growth is very strong and financial performance is very good and stable, in contrast to many health systems. Though we expect capital spending to remain high over the next several years as SHC constructs additional outpatient capacity, the organization should be able to maintain favorable leverage metrics. Fundraising, which is a notable strength of Stanford University, benefits SHC through fundraising for medical research and funds to support the school of medicine.

Exhibit 1
Operating leverage will remain low and days cash good over the near term



Source: Moody's Investors Service

Credit strengths

» Maintenance of good financial performance during a period when many health systems experienced margin compression

» SHC is a wholly owned subsidiary of Stanford University and benefits 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 our expectation that SHC will continue to generate good cash flow allowing it to fund strategic priorities while maintaining adequate leverage metrics.

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 2

Stanford Health Care, CA

	2018	2019	2020	2021	2022
Operating Revenue ($'000)	4,910,546	5,390,002	5,501,117	6,726,200	7,314,237
3 Year Operating Revenue CAGR (%)	12.3	10.1	7.3	11.1	10.7
Operating Cash Flow Margin (%)	8.9	9.2	4.3	13.7	9.6
PM: Medicare (%)	41.4	41.8	42.6	42.1	43.0
PM: Medicaid (%)	12.7	12.8	13.1	14.0	14.7
Days Cash on Hand	239	225	260	304	263
Unrestricted Cash and Investments to Total Debt (%)	159.2	165.3	170.3	220.3	217.5
Total Debt to Cash Flow (x)	3.2	2.8	5.2	1.9	2.3

Based on audits for Stanford Health Care, fiscal year ended August 31
Transfers to Stanford University as operating expenses
Swap settlement payments reclassified to interest expense
Investment returns normalized at 5%
2020 includes Medicare advances in unrestricted cash accounting for about 10% of unrestricted cash balances (advances were fully repaid by FYE 2021)
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 drives excellent market position

SHC will continue to hold a very strong market position with very strong patient demand both locally and nationally. The hospital and clinics are highly regarded and patient demand far exceeds available bed capacity. SHC expanded the number of inpatient beds several years ago when it opened the new hospital and inpatient occupancy is regularly about 100%. Though length of stay has increased over the past year due in part to capacity constraints at other post-acute settings (this is a common challenge at many organizations across the country), management reports that the number of transfer requests would still exceed available capacity even if length of stay were reduced to pre-pandemic levels.

SHC's ownership by Stanford University (Aaa stable) imparts many strategic and credit benefits. SHC partners closely with Stanford's school of medicine and Lucile Salter Packard Children's Hospital (A1 stable), both of which have strong reputations and contribute to a strong research environment. Fundraising is an exceptional strength at Stanford and SHC benefits directly and indirectly from strong fundraising for the school of medicine by lowering the financial burden on the hospital (dean's tax) and through a portion of philanthropy that is used to support direct hospital initiatives.

In addition to high acuity inpatient care at the main hospital, SHC will continue increasing its presence in the community through partnerships and its own clinics and affiliated physicians. It will open a community facing outpatient oncology center with Sutter Health (A1 stable)

Operating performance, balance sheet, and capital plans: strong margins relative to industry; capital spending to remain high

We expect SHC to continue generating strong revenue growth and operating cash flow margins over the near term, driven by strong demand and the organization's favorable positioning vis-à-vis commercial payors. With various projects increasing capacity coming on line over the next few years, SHC is likely to maintain double digit revenue growth and operational efficiencies that have kept cost per adjusted discharge relatively flat over the last few years will continue yielding benefits, enabling the organization to grow absolute cash flow while maintaining relatively stable margins.

Length of stay, labor and other expense inflation and other issues will continue to present operational headwinds, but SHC has demonstrated ability to adapt and manage within constraints. Like most other health systems, average length of stay is up significantly, rising about an entire day compared to pre-pandemic. This is consistent with the experience many other health systems reflecting reduced capacity in post acute settings. Wage inflation remains a challenge in the high cost Bay Area. Following a nurses strike during fiscal 2022, labor issues are likely to be muted over the near term.

Capital spending will remain high over the next several years driven by spending on new projects and renovations to existing facilities that will accommodate volume growth and program expansion. Though spending may potentially exceed cash flow from operations, SHC could likely finance the balance from philanthropy and investment returns. There are currently no new money debt plans, though SHC's leverage metrics have improved over the last several years with the organization's growth.

Liquidity

SHC currently has about $4.7 billion of unrestricted cash and about 250 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

Though there are no new money debt plans, leverage will decrease significantly over the next several years as SHC hits its growth and operational targets.

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 typically ranges from 2.8x - 3.5x and was 3.4x as of March 2023.

Debt-related derivatives

SHC has $573 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 sometimes exceeding $300 million. With sustained interest rate increases, the program's liabilities have decreased to $129 million and there is no collateral currently posted. Even when collateral posting has been required, it is manageable given SHC's cash position.

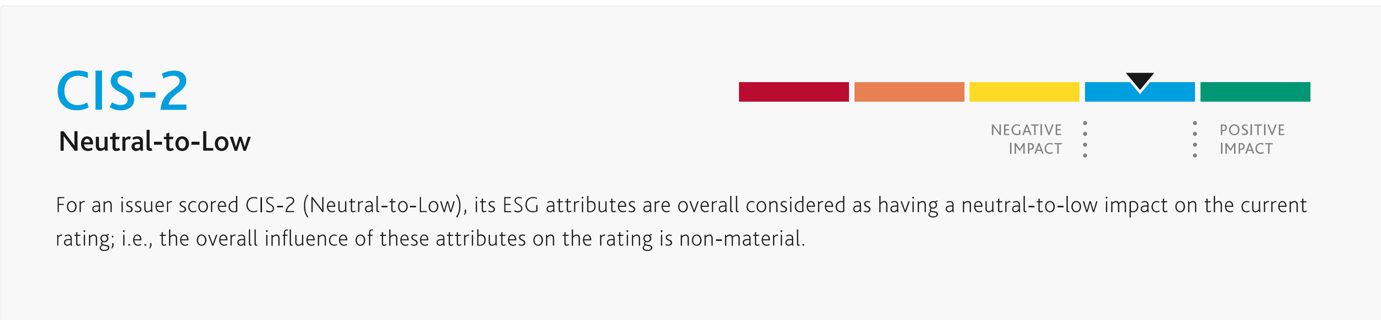
Pensions and OPEB

SHC has a small defined benefit plan that was fully funded (or 99% funded) over the last several years. The plan's liabilities are relatively small (PBO has ranged between $167 million and $220 million over the last several 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

Stanford Health Care's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

Stanford Health Care's ESG Credit Impact Score is neutral-to-Low (**CIS-2**). The hospital's strong reputation, good governance, and good wealth levels serve as mitigants to its ESG risks.

Exhibit 4
ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

The E-IPS is neutral-to-low (**E-2**) across all categories. While SHC's location in Northern California routinely exposes it to wildfire and water shortage risks, the university and healthcare enterprises have extensive risk management plans in place that addresses these and other risks. Stanford University has adopted a comprehensive sustainability initiative that includes a number of strategies across the enterprise including a longer-term goal of net zero greenhouse gas emissions.

Social

SHC's S-IPS is moderately negative, in line with national averages reflecting several factors including a growing reliance on government payors and the potential for issues regarding cost and access to healthcare to negatively impact hospital reimbursement and cash flow. Despite this risk, SHC has strong patient demand and significant scale to help offset some of these challenges. SHC's neutral customer relations score reflects its strong brand name, excellent clinical and research reputations and very high quality of care, resulting in strong patient demand and consistently high occupancy levels and very high case mix. Other social factors are in line with national averages including human capital, which we asses as moderately negative. SHC is located in a high cost area and many nurses and other workers commute long distances; competitive pay practices help mitigate this risk. Nurses are represented by a union which has held strikes.

Governance

SHC's G-IPS is neutral-to-low (**G-2**) and all sub-factors are scored at neutral-to-low with the exception of financial strategy and risk management, which we assess as positive (G-1). Management regularly conducts multi-year strategic and operational planning and has a track record of meeting or exceeding budget and has kept cost per adjusted discharge growth lower than average in recent years. Close collaboration with the university benefits SHC through investment management and fundraising through donations for major capital projects and through money raised to support medical education and research, which lowers the burden on the health system to support these activities. Stanford University is the sole corporate member of SHC and appoints its board of directors.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

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