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Ratings

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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	Affirmed
Stanford Hlth Care taxable commercial paper nts ser 2021A dtd 04/01/2021 due 10/01/2021		
Short Term Rating	A-1+	Affirmed
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	Affirmed
California Health Facilities Finance Authority (Stanford Hlth Care)		
Long Term Rating	AA-/Stable	Affirmed
Unenhanced Rating	NR(SPUR)	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	Affirmed
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	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'AA-' 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)
- 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 unissued taxable CP) on our view of SHC's own liquidity and procedures for handling potential tenders.
- The outlook, where applicable, is stable.

Security

Gross revenue, including patient revenue from hospital-based services along with numerous outpatient clinics, secures the bonds.

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, and expanded services at its East Bay location in Alameda (Stanford Health Care Tri-Valley) should further augment its business 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, dba Stanford Medicine Partners); and solid research funding aid these factors. Other credit strengths are a solid fundraising program and SHC's location in Silicon Valley, a favorable demographic area and home to numerous technology-related companies.

The rating incorporates our view of SHC's healthy financial performance, albeit with some support from COVID-19-related stimulus funds in recent years, augmented by delivery of high-acuity volumes and a favorable payer mix and that puts SHC in a favorable position as it embarks on elevated capital spending for projects both on the main campus and in the surrounding areas. Debt remains moderate, while unrestricted reserves are broadly stable despite the downturn in the investment markets over the past year. SHC's healthy capital appetite supports demand as well as seismic upgrades. We believe SHC's cash flow, if sustained at recent years' levels, should support that spending. We recognize that some capital spending can be slowed if needed, but that higher spending will likely continue for several years. No new money debt is planned for the next year.

The rating reflects a positive adjustment for SHC's close relationship with the higher-rated Stanford University. In addition, while we make a negative adjustment to reflect a more holistic view of the credit profile and SHC's leaner financial profile (relative to medians), we could consider removing this adjustment if SHC is able to generate consistent performance, excluding any COVID-19 relief funding, increase reserves and improve debt-related metrics while sustaining healthy cash flow amid likely continued heightened capital spending.

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

- Excellent position as a premier academic medical center with a strong academic partner highlighted by high occupancy and a comprehensive tertiary and quaternary mix of services as reflected in a very high Medicare case mix index;
- Solid cash flow in 2021 and 2022 that continues through interim 2023;
- Good unrestricted reserves, which, along with a focus on healthy cash flow, should be able to support capital spending plans over the next few years;
- Sound strategy of expanding its overall footprint through outpatient expansion, physician recruitment, and partnerships, combined with needed inpatient renovations on the main campus to position SHC well for demand and growth; and
- 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.

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

- Elevated capital spending expected for a number of years;
- Moderate debt;
- Dependence on investment markets to maintain reserve growth, particularly given the lighter reserves relative to

medians and likely ongoing capital spending; and

- Location in a competitive service area.

Environmental, social, and governance

We view SHC's overall environmental physical risks as elevated within our credit analysis 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 neutral to our credit analysis with favorable demographic service area characteristics lowering social capital risks, but offset by higher cost of living and human capital risks tied to increased labor costs, access to labor, and exposure to labor unions. Unions represent approximately 30% of SHC's staff, although relationships with the union have thus far been managed adequately. The collective bargaining agreement with the Committee of Recognition of Nursing Achievement (CRONA), representing about 3,000 employees, resulted in a strike in March 2022 that lasted a week and was successfully negotiated. While we also view governance as neutral to our credit analysis, we look favorably on good discipline that the entire Stanford University management and governance bring to SHC coupled with a consistent and focused strategy, use of performance metrics to track goals, and overall risk management practices.

Outlook

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 given its ongoing delivery of higher-acuity services and expanded partnerships. The outlook also reflects our view of management's ability to balance capital spending with overall balance sheet trends.

Upside scenario

We believe SHC's enterprise profile is consistent with a higher rating, and a positive outlook or rating action could result from a trend of operating margins consistent with those of recent fiscal years and excluding external support form COVID-19-related funds, combined with further improvement in balance sheet metrics to increase flexibility for the heightened capital spending that we believe will continue for several years.

Downside scenario

Given the performance trends and impressive demand for services, we believe SHC has flexibility at the rating and don't view a lower rating as likely. However, we could consider a lower rating or negative outlook if SHC sustains reduced cash flow that cannot support the higher capital spending or if reserves decline materially. Although we believe SHC has capacity for some 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 in Palo Alto, with an additional inpatient facility in the East Bay and a wide regional ambulatory care network, including both faculty and community (Stanford Medicine Partners) physicians. SHC draws patients broadly from both the immediate Santa Clara and San Mateo counties as well as from the broader region. SHC is running at very high capacity with maintenance of a very high case mix index of more than 2.500. Management reports that with increased demand, the team continues to improve throughput and efficiencies to serve more patients. Management reports that it is focused on partnerships with acute care providers in the market as well as capital and operating investments to support growing tertiary and quaternary services to support the overall demand. 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 and expanded cardiology and orthopedic services through its faculty physicians at Stanford Health Care Tri-Valley. Volumes have historically grown but are subject to capacity constraints, which management is working to alleviate through projects, efficiencies, and partnerships.

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 School of Medicine (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 transfers a sizable but generally stable sum in recent years, of 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 performance includes expenses of about $95 million (in 2022) with small amounts for capital excluded. A portion of those expenses are provided to SOM only when SHC's operating income reaches a specific threshold. 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, Stanford Medicine Children's Health (also known as Lucile Salter Packard Children's Hospital at Stanford), are separately rated, as the university does not guarantee SHC's debt and as SHC and Stanford Medicine Children's Health are not co-obligated.

Stable management team focuses on partnerships and growth

SHC's management team continues to execute on the strategic plan that 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 focuses on innovation in care delivery and on promoting value and expanding digital capabilities both for improving the patient experience and aiding the clinical care model. SHC is focused on partnerships rather than acquisitions. SHC's capital projects, mostly on the main campus and the surrounding areas, should support capacity constraints, but the team looks for innovative ways to expand services to the region with partnerships and some of its existing assets.

Table 1

Stanford Hospital and Clinics Utilization				
	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--		
	2022	2022	2021	2020
PSA population - nine-county service area	N.A.	N.A.	7,700,000	7,750,000
PSA market share (%)	N.A.	N.A.	3.4	3.3
Inpatient admissions*	10,586	39,589	37,082	35,133
Equivalent inpatient admissions	22,220	84,884	80,688	76,516
Emergency visits	36,937	133,511	118,220	107,318
Inpatient surgeries	3,794	14,347	14,118	13,644
Outpatient surgeries	9,341	34,498	31,361	26,296
Medicare case mix index	2.64	2.58	2.66	2.51
FTE employees	16,692	15,841	14,911	14,816
Active physicians	2,830	2,823	2,763	2,693
Medicare (%)§	21.8	21.6	21.7	22.1
Medicaid (%)§	5.9	7.4	6.3	6.0
Commercial/Blues (%)§	66.4	66.6	69.0	68.9

*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

Healthy cash flow likely to continue, even without COVID-19-related funds

SHC's key strength is solid cash flow and that has continued in recent years (and despite one-time expenses related to 2022's nurses strike), albeit with some COVID-19 relief funding. With no COVID-19 relief funding, interim fiscal 2023 margins are still healthy and consistent with those of 2022 but slightly lower than those of 2021, given higher wages and temporary labor costs. A favorable payer mix and higher-acuity services, along with a disciplined approach to expense management, are key contributors to performance and cash flow. Fiscal 2022 results also included one-time expenses associated with the five-day nursing strike. The negotiated three-year contract incorporates wage increases that are higher than those of previous years' contracts but in line with other union negotiated contracts across the country. As noted, we moved about $95 million of transfers to the SOM into operating expenses. Excluded are transfers to the SOM for capital that totaled about $17 million in 2022.

Management has forecast operating performance at levels generally consistent with those of recent years, which we view as achievable given the level of care provided, but this will require good expense management given industry difficulties. Historically, SHC's healthy margins have depended minimally on provider tax and disproportionate share revenue.

Investment income mostly supports excess income. 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 attenuated through 2022 and 2023, primarily as a result of declines in the investment markets and pickup in capital spending. Capital spending has begun to ramp up for renovations at 300 Pasteur (the previous main hospital next to the new tower) and for other ambulatory projects. Capital expenditures to depreciation are projected to be around 2.0x to 2.5x annual depreciation for the next several years . That said, the projects are discrete and spending can be managed. In addition to renovations at 300 Pasteur, larger capital projects include a cancer center in partnership with Sutter Health in the East Bay, an expanded outpatient facility in Redwood City, 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. SHC (in conjunction with Stanford University) is in the planning stages for its next large fundraising campaign.

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.

Debt-related metrics remain moderate with slow improvement

SHC is still digesting debt for its new tower (opened 2019), and we consider most debt-related metrics slightly weaker than those of similarly rated peers though improving and with smoothed debt burden very modest. 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 variable-rate demand bonds and put bonds have short- and medium-term remarketing risk and four bullet payments create some long-term risk. There are no net new additional debt plans, but management is monitoring the most appropriate ways to finance capital needs.

SHC has a diverse but sizable swap portfolio of floating- to fixed-rate swaps with a notional amount of $573 million, or about 25% of total debt outstanding, at Nov. 30, 2022. As of November 2022, SHC had no collateral posted with the mark-to-market on the swap portfolio at a $112 million liability. SHC's overall counterparty exposure is diversified and divided among four major institutions.

As of Feb. 28, 2023, SHC identified $1.2 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.

SHC's pension is well funded, as the plan was frozen in 1997 with a small liability, but had a slightly elevated though manageable postretirement benefit liability of $117 million at fiscal year-end Aug. 31, 2022.

Table 2

Stanford Hospital and Clinics Financial Summary

	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--			'AA-' rated stand-alone hospital medians
	2022	2022	2021	2020	2021
Financial performance					
Net patient revenue ($000s)	1,846,851	6,997,778	6,170,789	5,257,909	943,415
Total operating revenue ($000s)	1,899,475	7,412,467	6,771,846	5,566,097	994,416
Total operating expenses ($000s)	1,796,070	7,008,968	6,215,265	5,587,308	996,608
Operating income ($000s)	103,405	403,499	556,581	(21,211)	48,200
Operating margin (%)	5.44	5.44	8.22	(0.38)	3.60
Net nonoperating income ($000s)	(10,366)	101,023	59129	41,568	47,279
Excess income ($000s)	93,039	504,522	615,710	20,357	107,381
Excess margin (%)	4.93	6.71	9.01	0.36	9.30
Operating EBIDA margin (%)	9.95	10.32	13.94	5.78	9.70
EBIDA margin (%)	9.45	11.53	14.69	6.48	14.00
Net available for debt service ($000s)	178,594	866,232	1,003,240	363,327	175,225
MADS ($000s)	134,674	134,674	134,674	134,674	21,054
MADS coverage (x)	5.30	6.43	7.45	2.70	7.80
Operating-lease-adjusted coverage (x)	3.56	4.27	4.75	2.02	6.20
Liquidity and financial flexibility					
Unrestricted reserves ($000s)	4,623,259	4,819,738	4,916,124	3,416,123	1,073,707
Unrestricted days' cash on hand	243.7	261.1	302.8	234.0	403.9
Unrestricted reserves/total long-term debt (%)	204.3	211.6	213.4	153.5	347.6
Unrestricted reserves/contingent liabilities (%)	1,418.5	1,478.8	1,508.4	995.4	1,316.1
Average age of plant (years)	10.2	9.5	8.0	8.0	12.1
Capital expenditures/depreciation and amortization (%)	179.0	135.4	90.8	120.5	101.5
Debt and liabilities					
Total long-term debt ($000s)	2,262,858	2,278,272	2,303,275	2,224,863	280,159
Long-term debt/capitalization (%)	26.9	27.6	28.8	34.7	18.1
Contingent liabilities ($000s)	325,915	325,915	325,915	343,200	112,097
Contingent liabilities/total long-term debt (%)	14.4	14.3	14.2	15.4	26.8
Debt burden (%)	1.78	1.79	1.97	2.40	1.80
Defined benefit plan funded status (%)	N.A.	98.55	100.11	96.06	97.50
Miscellaneous					
Medicare advance payments ($000s)*	0	0	0	397,393	MNR
Short-term borrowings ($000s)*	0	0	0	0	MNR
CARES Act and other COVID-19-related grants ($000s)	0	215,316	410,467	136,551	MNR
Risk based capital ratio (%)	N/A	N/A	N/A	N/A	MNR

Table 2

Stanford Hospital and Clinics Financial Summary (cont.)					
	--Three months ended Nov. 30--	--Fiscal year ended Aug. 31--			'AA-' rated stand-alone hospital medians
	2022	2022	2021	2020	2021
Total net special funding ($000s)	38,147	60,635	21,730	25,209	MNR

*Excluded from unrestricted reserves, long-term debt, and contingent liabilities. There are nonmaterial balances of Medicare advance payments. Please note that noncapital transfers to Stanford Universit's School of Medicine are included in operating expenses. Nonmaterial amounts of noncontrolling expense for several majority owned joint ventures are not included in operating expense. MADS--Maximum annual debt service. MNR--Median not reported. N/A--Not applicable.

Credit Snapshot

- 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 676-staffed-acute-care-bed hospital directly adjacent to Stanford University and the 207-staffed-bed Stanford Health Care -- Tri-Valley (as of November 2022). The organization also includes joint ventures with Stanford University and other entities, Stanford 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