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Health and Educational Facilities Board of the City of Johnson City, Tennessee Ballad Health; Joint Criteria; System

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Health and Educational Facilities Board of the City of Johnson City, Tennessee

Ballad Health; Joint Criteria; System

Credit Profile		
US\$145.3 mil hosp rev rfdg bnds (Ballad Health) ser 2023A due 07/01/2034		
<i>Long Term Rating</i>	A-/Stable	New
US\$42.2 mil hosp rev imp bnds (Ballad Health) ser 2023B due 07/01/2033		
<i>Long Term Rating</i>	A-/Stable	New

Credit Highlights

- S&P Global Ratings assigned its 'A-' rating to the Health and Educational Facilities Board of the City of Johnson City, Tenn.'s \$145.3 million series 2023A revenue refunding bonds and \$42.2 million series 2023B hospital revenue improvement bonds, issued for Ballad Health (Ballad), Tenn.
- At the same time, S&P Global Ratings affirmed its 'A-' long-term rating and underlying rating (SPUR) on various bonds outstanding, issued for Ballad; and 'AA/A-1' and AA/A-1+ joint ratings on specific series of revenue bonds outstanding.
- For the joint criteria ratings, the long-term component of the rating is based on the application of our joint criteria assuming low correlation between the obligor and the irrevocable direct-pay letter of credit (LOC) provided by the banks. The short-term component of the rating is based on our short-term issuer credit rating on the respective banks. The short-term component of the rating addresses the likelihood that bondholders will receive interest and principal payments if they exercise the put option.
- The outlook, where applicable, is stable.

Security

Securing the bonds is a gross revenue pledge of the obligated group, which includes the parent Ballad Health, Mountain States Health Alliance (MSHA), Wellmont Health System (Wellmont), and a majority of the hospital facilities. The only Ballad hospital that is not a member of the obligated group is Johnston Memorial. The obligated group members comprise approximately 84% of Ballad's total assets and 89% of its total revenues.

Bond proceeds will be used to refund a portion of the series 2018A bonds and to reimburse project costs.

Credit overview

The rating reflects our opinion of Ballad's strong enterprise profile, with a solid business position covering a wide geographic area, good size and scale, and experienced management team. Ballad also maintains a sound financial profile, highlighted by favorable balance sheet metrics consistent with the rating despite the recent operating pressure due to elevated labor costs and inflation. Management continues to execute on key strategies following the 2018 merger of MSHA and Wellmont, some of which include enhancing its digital and information technology capabilities, focusing on opportunistic growth initiatives, with increased access and expansion of services in its core markets, and

continued consolidation where necessary to gain efficiencies and improve patient quality. In our opinion, management is successfully executing its integration strategy and realizing synergies, despite the disruption caused by the COVID-19 pandemic and increased labor and supply pressures.

We believe that there is some balance sheet flexibility with more than 200 days' cash on hand to contend with weaker performance during the outlook period despite higher leverage.

The rating also reflects a negative holistic adjustment due to the recent industry headwinds that have led to operating weakness. We would look for a sustained track record of financial improvement given the continued integration of the system and rebuilding of the balance sheet over the outlook period prior to removing this. We note that there is also high leverage, high reliance on a weaker payer mix, and reliance on special funding.

In our view, management has navigated the challenges well to date and has realized about \$409.8 million in synergies, which is above target. In addition, Ballard has recognized significant CARES Act and other relief funding, with \$78.5 million and \$96.7 million recognized through the nine months ended March 31, 2022, and fiscal 2021, respectively.

The rating further reflects our assessment of Ballard's:

- Excellent business position, with a leading inpatient market share at 73.8% in its 21-county primary service area with relatively stable demographics, although limited economic characteristics;
- Generally solid unrestricted reserves with days' cash on hand of 213.5 and 105.5% unrestricted reserves to long-term debt as of March 31, 2023;
- Adequate pro forma maximum annual debt service (MADS) coverage of 2.67x as of March 31, 2023, despite weaker earnings and an expected loss from operations for fiscal 2023; and
- Experienced management team that continues to focus on integration of the larger system and care coordination to transform Ballard into a high-performing consolidated system.

In our view, partially offsetting rating factors include our assessment of Ballard's:

- Near-term uncertainty about the pace of the rebound in business volume, and likely elevated expense pressures related to labor and supplies;
- Challenged payer mix with a modestly declining commercial mix, increasing reliance on governmental payers, and high reliance on special funding; and
- High leverage with debt to capitalization of 45.5% and a debt burden of 3.64%.

Environmental, social, and governance

While we view social risk as neutral in our credit analysis, we note that Ballard has a somewhat high reliance on special funding and a high reliance on governmental payers. We view the health and safety risks of the COVID-19 pandemic as lessened, but continue to believe the sector remains exposed to elevated labor costs that could pressure operations. Finally, we believe environmental and governance risks are neutral in our credit analysis.

Outlook

The stable outlook reflects our expectation that Ballad will retain its financial strength and business position while it complies with certificate of public advantage (COPA) and cooperative agreement (CA) guidelines. In addition, we believe management will continue positioning the organization to sustain its leading market position while pursuing strategic growth and continued integration opportunities, contributing to an overall credit profile that is consistent with the rating despite industry challenges. We also expect operational performance will continue to improve over the outlook period and that unrestricted reserves will be maintained.

Downside scenario

We could revise the outlook to negative or lower the rating if there is a significant and prolonged deterioration in operations or a large decline in unrestricted reserves. In addition, an increase in debt could result in a downgrade given already-high leverage. We could also lower the rating if there is significant weakness in the enterprise profile. We will also continue to assess the impact of any issues related to operating under the COPA.

Upside scenario

We are unlikely to raise the rating during the outlook period due in part to industry pressures, notably elevated labor and supply costs as well as decreased unrestricted reserves since fiscal 2021. However, over time, we could consider revising the outlook to positive or raising the rating if Ballad continues to realize the benefits of integration and attains the projected synergies that are needed to spur improvement in operations and balance sheet metrics in line with a higher rating.

Credit Opinion

Enterprise Profile--Strong

Formation of Ballad Health

Ballad Health was formed on Feb. 1, 2018, following a full asset merger between Wellmont and MSHA. The two health systems applied for a COPA under the Tennessee Hospital Cooperation Act of 1993 amended in 2015; and a CA, a similar document, in Virginia as authorized by Virginia law passed in 2015. Both the COPA and CA were issued by the states under clearly articulated policy passed by the legislature and signed by the governors with a series of contingencies aimed at improving the overall health of the population, expanding access points, and supporting health research and medical education. Both states monitor the system and the fulfillment of COPA and CA conditions on an ongoing basis.

Organizational overview and business position

Ballad is a 3,009-bed (1,425 beds in service) acute-care regional health system that serves 29 counties in northeast Tennessee, southwest Virginia, southeastern Kentucky, and western North Carolina. Local economic fundamentals are limited, with generally stagnant population growth expected, while per capita personal incomes and employment growth are significantly below state and national rates over the next five years.

Ballad garners 73.8% inpatient market share in its 21-county primary service area that includes about a million residents. The system captures a very healthy 62.7% from its total 29-county service area. Competition for inpatient services is limited to a number of smaller hospitals mainly located in counties within the service area surrounding the Tri-Cities region of Kingsport, Johnson City, and Bristol, Tenn. The system's primary competitors providing comparable tertiary services are in areas within the four states where Ballad operates, but outside of the service area. Ballad also includes the region's only children's hospital; a range of outpatient facilities; and ancillary services, including a home health agency, a hospice, and other activities such as the ownership and management of medical office buildings. The market for outpatient services remains competitive.

Stable and steady leadership team that has been focused on integration and execution

The senior leadership team includes members of both organizations as well as executives from outside Ballad. In our opinion, Ballad has an experienced management team that has responded well to the challenges of the pandemic and taken a proactive approach to the merger that includes developing a strong strategic vision, setting explicit financial and non-financial goals, aligning executive and functional leadership, integrating cultures, and leveraging integration best practices. Furthermore, we believe management is making some difficult decisions around the need to consolidate services across the system, and to improve quality and performance, while maintaining access across the region.

Table 1

Ballad Health, Tennessee--Enterprise statistics				
	--Nine months ended March 31--	--Fiscal year ended June 30--		
	2023	2022	2021	2020
PSA population	N.A.	950,000	951,364	946,708
PSA market share (%)	N.A.	73.8	74.6	74.3
Inpatient admissions	63,960	82,953	82,755	81,539
Equivalent inpatient admissions	155,301	201,095	217,193	222,669
Emergency visits	293,830	371,384	335,906	375,049
Inpatient surgeries	13,276	15,993	16,537	18,063
Outpatient surgeries	28,751	34,603	33,722	40,419
Medicare case mix index	1.7400	1.7300	1.6900	1.6400
FTE employees	11,522	11,556	11,442	12,823
Active physicians	2,403	2,403	2,023	2,138
Top 10 physicians admissions (%)	N/A	N/A	N/A	N/A
Based on net/gross revenues	Net	Net	Net	Net
Medicare (%)	50.2	49.5	49.5	47.4
Medicaid (%)	12.1	11.1	10.6	12.3
Commercial/Blues (%)	33.7	34.8	35.4	35.5

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

Financial Performance--Strong

Financial performance is expected to remain muted with a slow recovery over the outlook period given industry headwinds

Ballad's financial performance has historically been solid despite recent operating pressures; however, operations were slightly negative through the nine months ended March 31, 2023, with a negative 0.9% margin spurred by elevated labor costs and inflation. Ballad reported margins of 1.26% and 1.42%, respectively, for fiscal years 2022 and 2021. Both of these periods benefited from significant CARES Act and other relief funding of \$ 78.5 million and \$96.7 million, respectively.

Prior to the pandemic, management was making progress on many fronts, and was implementing cost reductions and efficiencies to maintain positive operations. Despite the recent operating pressure, we believe management has been able to navigate through a challenging period and maintain solid liquidity, good cash flow, and continued sufficient MADS coverage, with no expectation of breaching a rate covenant or other financial covenant.

Although Ballad still needs to demonstrate a return to consistently positive operating results over a longer period, we believe management has successfully executed a strategy for improvement through cost containment and further consolidation of services where appropriate, while being opportunistic in adding services or expanding access, which should bode well and support the long-term growth and strategy of the organization. Furthermore, liquidity has remained a core credit strength and provides some financial flexibility at the current rating. In addition, MADS coverage has remained solid and was 2.67x for the nine months ended March 31, 2023.

Liquidity and financial flexibility remain solid but have dipped slightly

We consider Ballad's balance sheet solid for the rating, with unrestricted cash and investments of \$1.3 billion (213.5 days' cash on hand and 1.1x long-term debt). The long-term debt includes total system debt but excludes the \$157.2 million (aggregate balance as of March 31, 2023) promissory notes that Ballad used to fund its non-controlling interest in Johnston Memorial and its non-controlling interest in Norton Community, which are fully collateralized by and paid out of an escrow account. The system's current average age of plant is almost 15 years, which is above medians, and the system has what we consider modest capital plans during the next several years. As a result, we believe that Ballad will be able to comfortably maintain healthy days' cash, which should help offset near-term operating pressures.

Ballad continues to proactively manage the investment portfolio. As of June 30, 2022, approximately 13% of the combined system's assets are invested in cash, cash equivalents, and 21% fixed income; 47% in equities; and the remaining 20% in alternative investments. We believe there is sufficient liquidity in the portfolio to cover the amount of direct-purchase and variable-rate debt outstanding with \$1.36 billion of available cash compared with about \$415.8 million of contingent-liability debt.

Ballad has high leverage with limited defined-benefit plan risk and no new money debt plans

Ballad's long-term debt of \$1.3 billion is structured with 70% fixed-rate bonds and 30% of either variable-rate or direct-purchase debt. The contingent-liability debt is spread across three banks, with staggered expiration dates, which we view favorably. The direct-purchase debt includes covenants that are outside of the master trust indenture, including 1.15x debt service coverage and 75 days' cash on hand. The private-placement document contains a downgrade termination event if one rating agency's rating on Ballad falls below 'BBB'. Ballad is also party to two basis swaps and two total return swaps. The aggregate mark to market was negative \$8.8 million as of March 31, 2023. If the mark to market were to exceed \$22 million, Ballad Health would be required to post collateral.

The system's debt metrics are mixed, with debt as a percent of capitalization declining to levels generally consistent with our medians, while the debt burden remains slightly elevated. Ballard has no debt plans during the outlook period. Ballard maintains defined-contribution plans and some legacy defined-benefit plans, including Wellmont Health and Norton Community Hospital, both of which are frozen; the plans have minimal unfunded liabilities and are not considered a credit risk.

Table 2

	Ballard Health, Tennessee--Financial statistics				
	--Nine months ended March 31--	--Fiscal year ended June 30--			--Medians for 'A-' rated health care system--
	2023	2022	2021	2020	2021
Financial performance					
Net patient revenue (\$000s)	1,695,959	2,174,810	2,000,607	1,898,589	2,151,080
Total operating revenue (\$000s)	1,758,310	2,315,770	2,192,929	2,078,380	2,525,214
Total operating expenses (\$000s)	1,774,760	2,286,540	2,161,848	2,057,572	2,388,333
Operating income (\$000s)	(16,450)	29,230	31,081	20,808	70,095
Operating margin (%)	(0.94)	1.26	1.42	1.00	1.40
Net nonoperating income (\$000s)	40,212	114,063	31,565	(34,305)	54,300
Excess income (\$000s)	23,762	143,293	62,646	(13,497)	86,877
Excess margin (%)	1.32	5.90	2.82	(0.66)	4.00
Operating EBIDA margin (%)	7.64	9.38	10.82	10.00	6.60
EBIDA margin (%)	9.71	13.63	12.08	8.49	10.30
Net available for debt service (\$000s)	174,623	331,288	268,820	173,470	255,243
Maximum annual debt service (\$000s)	87,217	87,217	87,217	87,217	74,293
Maximum annual debt service coverage (x)	2.67	3.80	3.08	1.99	4.10
Operating lease-adjusted coverage (x)	2.39	3.33	2.63	1.76	3.00
Liquidity and financial flexibility					
Unrestricted reserves (\$000s)	1,298,883	1,295,432	1,732,341	1,481,432	1,476,126
Unrestricted days' cash on hand	213.5	220.8	316.7	282.3	215.80
Unrestricted reserves/total long-term debt (%)	105.5	104.0	136.4	113.0	142.60
Unrestricted reserves/contingent liabilities (%)	312.4	311.5	481.7	411.9	509.00
Average age of plant (years)	15.0	14.1	12.7	14.0	12.60
Capital expenditures/depreciation and amortization (%)	76.0	61.8	70.2	92.8	99.30
Debt and liabilities					
Total long-term debt (\$000s)	1,231,412	1,246,102	1,270,256	1,310,864	1,204,656.00
Long-term debt/capitalization (%)	45.5	46.6	40.4	45.1	41.00
Contingent liabilities (\$000s)	415,810	415,810	359,665	359,665	336,250
Contingent liabilities/total long-term debt (%)	33.8	33.4	28.3	27.4	27.20
Debt burden (%)	3.64	3.59	3.92	4.27	2.20
Defined-benefit plan funded status (%)	N/A	N/A	N/A	N/A	93.80

Table 2

Ballad Health, Tennessee--Financial statistics (cont.)					
	--Nine months ended March 31--	--Fiscal year ended June 30--			--Medians for 'A-' rated health care system--
	2023	2022	2021	2020	2021
Pro forma ratios					
Unrestricted reserves (\$000s)	1,298,883	N/A	N/A	N/A	MNR
Total long-term debt (\$000s)	1,231,412	N/A	N/A	N/A	MNR
Unrestricted days' cash on hand	213.5	N/A	N/A	N/A	MNR
Unrestricted reserves/total long-term debt (%)	105.5	N/A	N/A	N/A	MNR
Long-term debt/capitalization (%)	45.5	N/A	N/A	N/A	MNR
Miscellaneous					
Medicare advance payments (\$000s)*	0	53,150	178,925	200,099	MNR
Short-term borrowings (\$000s)*	0	0	0	0	MNR
CARES Act and other grants (\$000s)	4,859	60,948	96,673	85,448	MNR
Risk based capital ratio (%)	N/A	N/A	N/A	N/A	MNR
Total net special funding (\$000s)	111,032	136,643	114,766	88,442	MNR

*Excluded from unrestricted reserves, long-term debt, and contingent liabilities. N/A--Not applicable. N.A.--Not available. MNR--Median not reported. Inpatient admissions exclude normal newborn, psychiatric, rehabilitation, and long-term care facility facility admissions.

Credit Snapshot

- Security pledge: Securing the bonds is a gross revenue pledge of the obligated group, which includes the parent Ballad Health, MSHA, Wellmont, and a majority of the hospital facilities.
- Organization description: Ballad Health was formed Feb. 1, 2018, and operates 21 hospitals in Tennessee, Virginia, Kentucky, and North Carolina. In addition, Ballad operates at multiple non-acute-care sites throughout the service area, providing ambulatory surgery, diagnostic services, and testing, among other things.
- The obligated group represents the majority of assets and revenues of the consolidated system and is therefore considered core under our group rating methodology criteria. The only Ballad hospital that is not a member of the obligated group is Johnston Memorial. The obligated group members comprise approximately 84% of Ballad's total assets and 89% of its total revenues.

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 April 26, 2023)

Mountain States Health Alliance (MBIA) (National)
Unenhanced Rating

A-(SPUR)/Stable

Affirmed

Ratings Detail (As Of April 26, 2023) (cont.)

Greenville Health and Education Facilities Board, Tennessee

Ballad Health, Tennessee

Greenville Hlth & Ed Fac Brd (Ballad Health) Hosp

Long Term Rating A-/Stable Affirmed

Greenville Hlth & Ed Fac Brd (Ballad Hlth) Hosp

Long Term Rating AA/A-1+ Affirmed

Unenhanced Rating A-(SPUR)/Stable Affirmed

Health & Educational Facilities Board of the City of Johnson City (The), Tennessee

Ballad Health, Tennessee

The Hlth & Educl Facs Brd of the City of Johnson City (Ballad Hlth) var rate hosp rev imp bnds

Long Term Rating AA/A-1 Affirmed

Unenhanced Rating A-(SPUR)/Stable Affirmed

The Hlth & Educl Facs Brd of the City of Johnson City (Ballad Hlth) var rate hosp rev rfdg bnds (Ballad Hlth) ser 2022B due 07/01/2045

Long Term Rating AA/A-1 Affirmed

Unenhanced Rating A-(SPUR)/Stable Affirmed

Health & Educational Facilities Board of the City of Johnson City (The), Tennessee

Mountain States Health Alliance, Tennessee

Johnson City Hlth & Ed Fac Brd (Mountain States Health Alliance)

Long Term Rating A-/Stable Affirmed

Johnson City Hlth & Ed Fac Brd (Mountain States Health Alliance) (MBIA) (National)

Unenhanced Rating A-(SPUR)/Stable Affirmed

Sullivan County Health Education & Housing Facility Board, Tennessee

Wellmont Health System, Tennessee

Sullivan Cnty Hlth Ed & Hsg Fac Brd (Wellmont Hlth Sys)

Long Term Rating A-/Stable Affirmed

Sullivan Cnty Hlth Ed & Hsg Fac Brd (Wellmont Hlth Sys)

Long Term Rating A-/Stable Affirmed

Many issues are enhanced by bond insurance.

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