S&P Global
Ratings

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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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Credit Profile		
US$121.9 mil var rate hosp rev rfdg bnds (Ballad Hlth) ser 2022B due 07/01/2045		
Unenhanced Rating	A-(SPUR)/Stable	New
US$53.1 mil var rate hosp rev imp bnds (Ballad Hlth) ser 2022C due 07/01/2035		
Unenhanced Rating	A-(SPUR)/Stable	New
The Hlth & Educl Facs Brd of the City of Johnson City, Tennessee		
Ballad Hlth, Tennessee		
The Hlth & Educl Facs Brd of the City of Johnson City (Ballad Hlth) var rate hosp rev imp bnds (Ballad Hlth) ser 2022C due 07/01/2035		
Long Term Rating	AA/A-1	Rating Assigned
Unenhanced Rating	A-(SPUR)/Stable	Rating Assigned
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	Rating Assigned
Unenhanced Rating	A-(SPUR)/Stable	Rating Assigned

Rating Action

S&P Global Ratings assigned its 'AA/A-1' long-term rating and 'A-' underlying rating to the Health and Educational Facilities Board of the City of Johnson City, Tenn.'s $121.9 million series 2022B revenue refunding bonds (Ballad Health) and $53.1 million series 2022C hospital revenue improvement bonds. 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 Health (Ballad). The outlook is stable.

The long-term component of the rating assigned to the series 2022B and 2022C bonds 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 Truist Bank N.A. ('A/A-1'). The long-term component of the rating addresses the likelihood that bondholders will receive interest and principal payments when due if they don't exercise the put option. The short-term component of the rating is based on our short-term issuer credit rating on Truist Bank N.A. 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 LOC fully supports all bond payment obligations when the bonds are in the weekly and daily interest modes. Therefore, our rating applies only during these covered modes. If the bonds are converted to a non-covered rate mode, we will likely change our rating.

Bond proceeds will be used to refund series 2012A bonds and 2018C bonds outstanding and reimburse project costs.

This issuance also includes $75 million of private-placement bonds with PNC Bank, which S&P Global Ratings does not rate. However, we have incorporated this debt into our analysis and have classified it as contingent. Shortly after the bonds are issued, Ballad expects to pay down a portion of the series 2018D bonds, with funds unrelated to the financing.

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 79% of Ballad's total assets and 89% of its total revenues.

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 and solid balance sheet metrics consistent with the rating despite the recent operating pressure as a result of COVID-19 pandemic-related challenges. 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 (IT) 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 remains focused on pursuing the integration strategy and realizing synergies, despite the disruption caused by the pandemic and increased labor and supply pressures. Liquidity continues to provide a cushion to offset any near-term operating pressure that could arise due to the challenging operating environment and near-term uncertainty associated with higher costs.

The rating also reflects a negative holistic adjustment that reflects the industry challenges, notably increased labor and supply costs, as well as continued integration of two sizable health systems. In addition, the adjustment reflects underlying challenges due to high leverage and high reliance on a weaker payer mix and reliance on special funding that create a financial profile in line with an 'A-' rating but not higher.

In our view, management has navigated the challenges well to date and has realized about $194.2 million in synergies, which is above target. In addition, Ballad has recognized significant CARES Act and other relief funding, with $56.7 million and $96.7 million recognized through the nine months ended March 31, 2022, and fiscal 2021, respectively. Ballad also bolstered its liquidity by accessing the Medicare Accelerated and Advance Payment Program and currently has $99 million outstanding, which will continue to be repaid through fiscal 2022. We note that the recent omicron surge led to increased agency staffing costs as well as higher supply costs that we do not expect to be recurring. Ballad also rolled out its health care IT implementation across the system over the past few years and it was on time and budget with minimal disruption.

The rating further reflects our assessment of Ballad's:

- Excellent business position, with a leading inpatient market share at 74% in its 21-county primary service area with relatively stable demographics, although limited economic characteristics;
- Generally solid balance sheet metrics with days' cash on hand of 238.7 and healthy pro forma maximum annual debt service (MADS) coverage of 4.5x as of March 31, 2022; and

- Experienced management team that continues to focus on integration of the larger system and care coordination to transform Ballad into a high-performing consolidated system.

In our view, partially offsetting rating factors include our assessment of Ballad'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 44.6% and a debt burden of 3.52%.

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. Ballad does not expect to issue additional debt and therefore we have not factored it into the rating.

Environmental, social, and governance

We analyzed Ballad's environmental, social, and governance risks relative to its economic fundamentals, market position, and the corresponding effects on its financial profile and determined that all are neutral. That said, the pandemic has exposed Ballad and its peers to additional social risks that have resulted in headwinds, including higher staffing and supply costs. We note that the primary service area also has a lower vaccination rate relative to that of the nation. In addition, the pandemic and higher costs have resulted in recent financial pressures that could persist in the near term. We note that Ballad also has a somewhat high reliance on special funding and a high percentage of governmental payers.

Stable Outlook

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 higher 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 (1,495 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 74% inpatient market share of its 21-county primary service area that includes about 1 million residents. The system captures a very healthy 63% 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 and purposeful 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--		
	2022	2021	2020	2019
PSA population	N.A.	951,364	946,708	1,155,343
PSA market share (%)	N.A.	74.6	74.3	63.2
Inpatient admissions	62,032	82,755	81,539	89,371
Equivalent inpatient admissions	156,429	217,193	222,669	247,013
Emergency visits	278,741	335,906	375,049	432,394
Inpatient surgeries	11,665	16,537	18,063	20,944
Outpatient surgeries	24,966	33,722	40,419	51,644
Medicare case mix index	1.7500	1.6900	1.6400	1.6300
FTE employees	11,603	11,442	12,823	13,984
Active physicians	2,023	2,023	2,138	1,623
Based on net/gross revenues	Net	Net	Net	Net
Medicare (%)	48.8	49.5	47.4	47.2
Medicaid (%)	11.2	10.6	12.3	10.7
Commercial/Blues (%)	35.7	35.4	35.5	36.6

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 remains solid despite pandemic and industry headwinds

Ballad's financial performance has been solid despite elevated labor and supply costs, with an operating margin of 1.81% for the nine months ended March 31, 2022, that includes $56.7 million of CARES Act and other relief funding that we do not expect to be recurring. Ballad reported margins of 1.42% and 1.00%, respectively, for fiscal years 2021 and 2020. Both of these periods benefited from significant CARES Act funding of $96.7 million and $85.4 million, respectively.

Before the pandemic, Ballad was coming off a positive operating performance in fiscal 2019, as management was making progress on many fronts, and was active in 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 added financial flexibility at the current rating. Management's fiscal 2022 projection is for a modest operating margin of 1%-2%. In addition, MADS coverage has remained solid and was 4.52x for the nine months ended March 31, 2022.

Liquidity and financial flexibility remain key credit strengths

We consider Ballad's balance sheet strong for the rating, with unrestricted cash and investments of $1.4 billion (238.7 days' cash on hand and 1.1x long-term debt). The long-term debt includes total system debt but excludes the $168.7 million promissory note that Ballad used to fund its non-controlling interest in Johnson Memorial, that is fully collateralized by 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 and as of June 30, 2021, approximately 45% of the combined system's assets are invested in cash, cash equivalents, and fixed income; 41% in equities; and the remaining 14% 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 $1.4 billion of available cash compared with about $419 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 71% fixed-rate bonds and 29% of either variable-rate or direct-purchase debt. The contingent-liability debt, which comprises less than 30% of total debt, is spread equally between four 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 new 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 $10.7 million as of March 31, 2022. 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. Ballad has no debt plans during the outlook period. Ballad 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

Ballad Health, Tennessee--Financial Statistics					
	--Nine months ended March 31--	--Fiscal year ended June 30--			--Medians for 'A-' rated health care systems--
	2022	2021	2020	2019	2020
Financial performance					
Net patient revenue ($000s)	1,629,588	2,000,607	1,898,589	2,044,986	2,076,521
Total operating revenue ($000s)	1,753,831	2,192,929	2,078,380	2,107,894	2,684,250
Total operating expenses ($000s)	1,722,151	2,161,848	2,057,572	2,067,663	MNR
Operating income ($000s)	31,680	31,081	20,808	40,231	MNR
Operating margin (%)	1.81	1.42	1.00	1.91	0.60
Net nonoperating income ($000s)	121,682	31,565	(34,305)	17,735	MNR

Table 2

Ballad Health, Tennessee--Financial Statistics (cont.)					
	--Nine months ended March 31--	--Fiscal year ended June 30--			--Medians for 'A-' rated health care systems--
	2022	**2021**	**2020**	**2019**	**2020**
Excess income ($000s)	153,362	62,646	(13,497)	57,966	MNR
Excess margin (%)	8.18	2.82	(0.66)	2.73	2.40
Operating EBIDA margin (%)	9.98	10.82	10.00	11.00	6.70
EBIDA margin (%)	15.82	12.08	8.49	11.74	8.00
Net available for debt service ($000s)	296,691	268,820	173,470	249,584	209,691
Maximum annual debt service ($000s)	88,112	88,112	88,112	88,112	MNR
Maximum annual debt service coverage (x)	4.49	3.05	1.97	2.83	3.30
Operating lease-adjusted coverage (x)	3.91	2.61	1.74	2.45	2.60
Liquidity and financial flexibility					
Unrestricted reserves ($000s)	1,403,596	1,732,341	1,481,432	1,395,573	1,287,932
Unrestricted days' cash on hand	238.7	316.7	282.3	264.2	205.80
Unrestricted reserves/total long-term debt (%)	112.0	134.8	113.0	105.9	112.60
Unrestricted reserves/contingent liabilities (%)	390.3	481.7	411.9	388.0	456.20
Average age of plant (years)	14.2	12.7	14.0	13.8	12.00
Capital expenditures/depreciation and amortization (%)	55.8	70.2	92.8	96.6	108.30
Debt and liabilities					
Total long-term debt ($000s)	1,253,313	1,284,657	1,310,864	1,317,279	MNR
Long-term debt/capitalization (%)	44.6	40.7	45.1	44.1	44.70
Contingent liabilities ($000s)	359,665	359,665	359,665	359,665	MNR
Contingent liabilities/total long-term debt (%)	28.7	28.0	27.4	27.3	25.20
Debt burden (%)	3.52	3.96	4.31	4.15	2.40
Defined-benefit plan funded status (%)	N/A	N/A	N/A	N/A	85.10
Pro forma ratios					
Unrestricted reserves ($000s)	1,403,596	N/A	N/A	N/A	N/A
Total long-term debt ($000s)	1,253,313	N/A	N/A	N/A	N/A
Unrestricted days' cash on hand	238.7	N/A	N/A	N/A	N/A
Unrestricted reserves/total long-term debt (%)	112.0	N/A	N/A	N/A	N/A
Long-term debt/capitalization (%)	44.6	N/A	N/A	N/A	N/A
Miscellaneous					
Medicare advance payments ($000s)*	99,004	178,925	200,099	N/A	MNR
Short-term borrowings ($000s)*	0	0	0	0	MNR
COVID-19 stimulus recognized ($000s)	56,653	96,673	85,448	N/A	MNR
Risk based capital ratio (%)	N/A	N/A	N/A	N/A	MNR

Table 2

Ballad Health, Tennessee--Financial Statistics (cont.)					
	--Nine months ended March 31--	--Fiscal year ended June 30--			--Medians for 'A-' rated health care systems--
	2022	2021	2020	2019	2020
Total net special funding ($000s)	91,857	114,766	88,442	80,150	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

- 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 79% 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 May 27, 2022)		
Mountain States Health Alliance (MBIA) (National)		
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
Greeneville Hlth and Ed Facs Brd, Tennessee		
Ballad Hlth, Tennessee		
Greeneville Hlth & Ed Fac Brd (Ballad Health) Hosp		
Long Term Rating	A-/Stable	Affirmed
Greeneville Hlth & Ed Fac Brd (Ballad Hlth) Hosp		
Long Term Rating	AA/A-1+	Affirmed
Unenhanced Rating	A-(SPUR)/Stable	Affirmed
Sullivan Cnty Hlth Ed & Hsg Fac Brd, 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)		

Ratings Detail (As Of May 27, 2022) (cont.)		
Long Term Rating	A-/Stable	Affirmed
The Hlth & Educl Facs Brd of the City of Johnson City, 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
The Hlth & Educl Facs Brd of the City of Johnson City (Mountain States Hlth Alliance) SYSTEM		
Long Term Rating	A-/Stable	Affirmed

Many issues are enhanced by bond insurance.