Doylestown Health

## Financial Covenants

Doylestown Health* is an independent, comprehensive healthcare system, providing hospital inpatient care and outpatient services; home care, hospice and palliative care; skilled nursing care; assisted living; physician practice; and wellness education, connected to meet the health needs of all.

This Release should be read in conjunction with Standard and Poor's Rating Action dated December 27, 2022, a copy of which is attached hereto.

For Doylestown Health, putting patients and community health first is our top priority, as we have done for nearly one hundred years. Despite our current challenges, our Doylestown Health Associates have not wavered from our mission – delivering the highest quality care in the region. The national recognitions we continue to receive for clinical excellence and patient safety and quality tell a unique story. Our 13th consecutive Grade "A" from the Leapfrog Group is just one example of their extraordinary commitment. Doylestown is the only hospital in Pennsylvania to accomplish this.

The COVID-19 pandemic brought new challenges and intensified others. Like many healthcare providers across the United States, Doylestown Health (DH)* is experiencing extraordinary and unprecedented financial hardship as the cost of delivering health care outpaces payments from commercial payers and federal and state governments.

We are one of MANY hospitals and healthcare systems currently facing a complex set of financial and operational challenges. Some of the factors contributing to these challenges include:

- Extraordinary unbudgeted costs due to the COVID-19 pandemic;
- Decreased patient volumes caused by the pandemic;
- Increase cost of personnel, reflecting higher base compensation for employed associates;
- Workforce shortages, resulting in the need for agency staff and premium pay to fill the gaps
- Multi-year payor contracts (insurance reimbursement) with pre-pandemic rates; and
- Government reimbursement shortfalls.

The Amended and Restated Bond Purchase and Bank Covenants Agreement (the "Bank Agreement") By and Among Doylestown Hospital ("Hospital") and Doylestown Health Foundation ("Foundation") and together with Doylestown Hospital, (the "Borrowers"), PNC Bank, National Association, as Agent for the Lenders (the "Agent"), relating to Doylestown Hospital Revenue Bonds, 2013 Series B contains certain financial covenants which must be met on an ongoing basis. We have been in discussions and are requesting the Agent for direct lenders to consider options, which may include a waiver and/or amendments to covenant ratios related to the Bank Agreement. This request would serve to reset the timeline and threshold measures over a period of time, thus enabling the organization to focus on recovery efforts in a responsible and meaningful way to position us for success going forward. For the full text of the Bank Agreement, see Event Based Disclosures for the Doylestown Hospital Authority—Financial Obligation, filed on EMMA on July 7, 2022 with respect to Doylestown Hospital Revenue Bonds, 2013 Series B.

In order to recover from the financial impact of the pandemic, we are undertaking a comprehensive look inside our organization and operations to identify opportunities for improvements, efficiencies, and enhanced sources of revenue. We are working with ECG, a national healthcare consulting firm with considerable experience in performance improvement, and we are moving forward with a number of preliminary recommendations. We will continue to implement opportunities throughout the coming months. Many of these will bring immediate as well as long-term benefits.

* *Collectively, Doylestown Health (DH) is comprised of the following:*

- *Village Improvement Association of Doylestown*
- *Doylestown Health Foundation d/b/a Doylestown Health*
- *Doylestown Hospital, which, in addition to the Hospital division, includes:*
    - *Pine Run Retirement Community ("Pine Run") (a continuing care retirement community, including the Village Independent Living, Health Center Skilled Nursing and Personal Care and Lakeview Personal Care)*
    - *Doylestown Hospital Home Health Care*
    - *Doylestown Hospital Hospice*
    - *Doylestown Hospital Palliative Care*
    - *Doylestown Hospital outpatient testing facilities at the Health and Wellness Center*
    - *Children's Village – early childhood education program*
    - *DR Cardiology*
    - *Covered Bridge Reciprocal Risk Retention Group*
- *VIA Affiliates d/b/a Doylestown Health Physicians ("DH Physicians") and its subsidiary corporation, DH Physicians Ambulatory Services ("Ambulatory Services")*

December 27, 2022

S&P Global
Ratings

RatingsDirect®

## Summary:

# Doylestown Hospital Authority, Pennsylvania
# Doylestown Hospital; Hospital

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Many issues are enhanced by bond insurance.

## Credit Highlights

- S&P Global Ratings lowered its long-term rating and underlying rating (SPUR) to 'CCC' from 'BB' on the Doylestown Hospital Authority, Pa.'s debt outstanding, issued on behalf of Doylestown Hospital (DH).
- S&P Global Ratings also placed the rating on CreditWatch with developing implications.
- The rating action reflects our expectation that DH will not meet its quarterly debt service coverage (DSC) covenant or semiannual days' cash on hand (DCOH) covenant tied to the directly placed series 2013B bonds, triggering an option by the banks and trustee to accelerate the debt, which creates significant liquidity risk given DH's level of unrestricted reserves. The rating action also reflects our view of a steep decline in operating performance resulting primarily from a higher expense base tied partly to elevated labor costs and resulting in a high cash burn rate.
- The CreditWatch placement reflects our view that there is a one-in-two chance we could either raise or lower the rating in the next 90 days pending the outcome of the hospital's request for a waiver or amendment to covenant ratios related to the hospital's series 2013B bonds. Considerations to resolve the CreditWatch placement include an update on the ability to secure a waiver, any potential acceleration or repayment of DH's debt outstanding, and initial results of the turnaround plan to stabilize operations and the cash burn rate.

### Security

DH's gross revenue as defined in the public bond documents (which includes the revenue of the Pine Run retirement community) secures the rated bonds, along with a mortgage lien.

### Credit overview

The rating reflects our view of DH's meaningful operating losses and high cash burn resulting from persistent financial and operating challenges facing the hospital, including a higher expense base following the operationalizing of a recent campus expansion in parallel with elevated labor costs and inflationary pressures through the five-month interim reporting period ended Nov. 30, 2022. In addition, key balance sheet ratios deteriorated further, leaving no cushion for unforeseen events and an inability to repay debt outstanding should the bank and bondholders choose the acceleration option. These financial stresses come at a time when overall volumes remain below pre-pandemic levels and management has had to contend with significantly higher labor costs, pre-pandemic reimbursement rates from payers, workforce shortages, and inflationary pressures. DH maintains a good position in the market but the broader market is quite competitive, with a number of stand-alone and health systems in the service area. While consolidated losses typically result from the DH physicians' entity, the fiscal 2022 and year-to-date fiscal 2023 interim period losses resulted roughly equally from the physicians' entity and the hospital.

The series 2013B direct placement bonds include covenants (based on DH and the foundation) requiring DSC of no less than 1.35x, 100 DCOH, and maximum debt to capitalization of 65%. The public bonds require DSC of at least 1.0x tested annually (1.1x for a consultant call-in). S&P Global Ratings does not rate the directly placed series 2013B bonds. Based on the five-month reporting period for the obligated group and according to DH calculations, 'DCOH has fallen to 89.6 days with a DSC ratio of 1.30x. Based on S&P Global Ratings calculations using consolidated figures for the system, unrestricted reserves to long-term debt declined to 42% (from 53% at fiscal year-end 2022). A covenant violation provides the banks the option to accelerate the series 2013B bonds, which are also cross-defaulted with the public bonds. The swap payments and the line of credit are on parity with the public debt and these documents contain no cross-default language. However, the valuation of the swap mark-to-market liability is not on parity.

The directly placed $60.4 million series 2013B debt is held by PNC and TD Bank (holding $15 million of that total). Under the bank agreement, the failure to meet bond covenants resulting from low DSC and DCOH creates significant near-term liquidity risk, in our view, especially if DH is required to repay its $212 million long-term debt outstanding. We understand that management has proactively requested a waiver or amendment to covenant ratios and expects a decision from PNC by late January 2023. Management notes that under the bond documents, the trustee will act only upon PNC's opting to notify it of an event of default. We also understand that management has proactively engaged an outside consultant to assist it with improving financial performance and that volumes remain sound.

The 'CCC' rating, by definition, indicates violations of financial covenants and the obligation's vulnerability to nonpayment within the next 12 months absent favorable business, financial, and economic conditions. We see heightened liquidity risk, including likelihood of default if the credit continues to deteriorate at a similar pace as in the first five months of fiscal 2023 or if management is unable to obtain the necessary bank waiver. We understand that DH made its December debt service payment in full and on time and that it will be making its upcoming interest payment in January 2023. We expect that management will keep S&P Global Ratings apprised of the status of the requested bank waiver related to the pending covenant violations on the series 2013B bonds.

For more information on DH's market position and enterprise profile, see our report published May 20, 2022, on RatingsDirect.

### Environmental, social, and governance

The rating action reflects our view of human capital social risks associated with unbudgeted costs stemming from the COVID-19 pandemic, including elevated labor costs related to workforce shortages that have resulted in increased use of agency staff and higher base rate compensation for employees and volumes that remain below pre-pandemic levels. These factors have led to outsized operating losses and negative cash flow in fiscal 2022 as well as higher-than-expected operating losses in fiscal 2023 to date. Although management has retained outside consultants to help identify and implement some measures to reduce the financial impact from increased staffing expenses, such as working with third-party payers to negotiate reimbursement rates, making revenue cycle improvements, and capturing operating efficiencies, we see considerable remaining operating pressure given wage and expense inflation, the increased expense base as a result of the recent campus expansion, and the competitive market dynamics.

We view DH's environmental and governance risks as neutral within our credit analysis.

### CreditWatch

The rating will remain on CreditWatch with developing implications while we await additional information from management during the CreditWatch period to learn the status and terms of the bank waiver. Failure to obtain a bank waiver could result in a negative rating action. However, and depending on final details and terms, a higher rating is possible should DH successfully obtain a bank waiver. Further rating actions will also be based on our assessment of management's near-term strategic plans to stabilize operations and the balance sheet.

## Related Research

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