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Ratings

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Massachusetts Development Finance Agency
Baystate Medical Center; Joint Criteria; System

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Unenhanced Rating	A(SPUR)/Stable	Downgraded
Massachusetts Development Finance Agency (Baystate Med Ctr) JOINTCRIT		
Long Term Rating	AA+/A-1+	Affirmed
Unenhanced Rating	A(SPUR)/Stable	Downgraded
Massachusetts Dev Fin Agy (Baystate Medical Center)		
Long Term Rating	A/Stable	Downgraded

Credit Highlights

- S&P Global Ratings lowered its long-term rating on the Massachusetts Development Finance Agency's series 2014N revenue bonds and its underlying rating (SPUR) on the series 2009J-1 and 2009J-2 bonds to 'A' from 'A+'.
- At the same time, S&P Global Ratings affirmed its 'AA+/A-1+' dual rating on the agency's series 2009J-1 and 2009J-2 bonds.
- All bonds were issued for Baystate Medical Center (BMC), a member of the obligated group of Baystate Health (Baystate).
- The outlook, where applicable, is stable.
- The rating action reflects our view of Baystate's accelerated and substantial operating loss in fiscal 2022 that has continued into 2023, absent stimulus funding, reflecting the pandemic and affiliated labor and supply expense pressures, commonwealth mandates to slow or discontinue admissions and procedures during COVID-19 spikes, and throughput issues.
- The 'AA+' long-term component of the rating is based jointly on Baystate and the letter-of-credit (LOC) provider, TD Bank N.A., and the 'A-1+' short-term component is based solely on TD Bank N.A., which provides an LOC expiring Dec. 18, 2024.

Security

Gross revenue and a mortgage from the system's flagship facility BMC and Baystate Total Home Care (inactive) secure the bonds.

Credit overview

The rating reflects our view of Baystate's weakened financial profile, including both softer underlying operations and diminished balance sheet cushion. In both fiscal 2022 and through the interim period, Baystate recognized ample federal stimulus support from the CARES Act, the Federal Emergency Management Agency, and from the American

Rescue Plan Act. Furthermore, Baystate recognized impactful funding from the Commonwealth of Massachusetts as a result of its safety net status. Management is focused on revenue-generating and cost-saving initiatives in the outlook period to bring the hospital to profitability in 2024 absent stimulus funding, but balance sheet metrics will likely be slower to respond.

Baystate's balance sheet metrics materially softened at fiscal and calendar year-end 2022 after a period of accretion. Historically, unrestricted reserves and days' cash on hand have been somewhat light for the rating, but cash to debt has been in line with rating medians. Management is focused on building the balance sheet with conservative capital expenditures, a new capital fundraising campaign, and no debt plans. In addition, management is focused on improving key balance sheet metrics, including days' cash on hand, over the outlook period. However, we believe that despite the planned accretion Baystate's balance sheet will remain more in line with an 'A' rating.

The rating also reflects Baystate's enterprise profile, characterized by its leading market position across three counties in Massachusetts' Pioneer Valley and historically solid demand for its services, especially at its tertiary flagship facility, BMC, which just completed and opened its new surgical operating rooms and interventional spaces. In addition, the rating incorporates our view of Baystate's integrated delivery system, which includes four hospitals, a nonprofit health plan (Health New England; HNE), and roughly 1,000 employed providers.

The rating reflects our view of Baystate's:

- Market leadership in a broad region of western Massachusetts;
- Diversified revenue stream and integrated operations;
- Typically healthy debt service coverage, bolstered by moderate debt; and
- Well-funded and de-risked defined benefit pension plan.

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

- Meaningful operating losses in fiscal 2022 and into 2023 absent provider relief funds;
- High contingent liabilities, although most of the bank loans are long-term, amortizing, fixed-rate securities;
- Dependence on special funding sources and BMC for a large portion of earnings; and
- Weakened balance sheet with metrics below expectations for the rating.

Environmental, social, and governance

While we view social risk as neutral within our credit rating analysis, we note that Baystate's payer mix is more heavily reliant on government payers and that the primary service area's economic indicators are on the weaker side. Furthermore, the pandemic has exposed Baystate and all health care providers to additional labor costs that are likely to continue through the outlook period, resulting in continued financial pressure in the near term. We view environmental and governance risks as neutral in our credit rating analysis.

Outlook

The stable outlook reflects our view that despite negative pressures on Baystate's operations, management has a sound strategy to end the year with break-even performance and a stable balance sheet. We also believe the system's market position lends some stability to the credit profile amid periods of weaker performance.

Downside scenario

We could revise the outlook to negative or lower the rating further if the system is unable to generate underlying operational improvement over the outlook period, including margins at break-even or better and debt service coverage that remains in line with the rating. We could also consider negative action with any further balance sheet weakening, including days' cash on hand and cash to debt. We could also consider a lower rating in the unlikely event of significant diminution to the enterprise profile or a large debt issuance without commensurate balance sheet accretion.

Upside scenario

Given recent operating and balance sheet weakening, we see no upside to the rating during the outlook period.

Credit Opinion

Enterprise Profile: Strong

New partnerships support a leading market position

Baystate serves Hampden, Franklin, and Hampshire counties, and its flagship hospital, BMC, is the largest private employer in Springfield (89 miles west of Boston and 25 miles north of Hartford, Conn.) in Hampden County, where it has a leading market share of 67%. The hospital has also leveraged its structure to pursue population health by assuming risk with HNE, other commercial insurers, and Medicare and Medicaid through its successful accountable care organization. Competition is low in Baystate's three-county region, especially for the tertiary services provided by BMC, with UMass Memorial Medical Center located 60 miles east of Springfield and Berkshire Health System, which has a strong cooperative relationship with Baystate, 60 miles west. Trinity Health owns a smaller hospital in Springfield. Baystate recently opened 32 new operating rooms and procedural suites at BMC that are expected to improve efficiencies, solidify the hospital's position as the sole provider of tertiary services in the region, and create space to backfill for additional capacity.

Further aiding market share is a recent joint venture initiative that Baystate has entered into with LifePoint Health for a behavioral hospital in Holyoke. Behavioral health demand in the area is high, and this facility will consolidate the system's beds for efficiency while adding 40 beds. The 150-bed hospital--with 30 beds contracted to the State of Massachusetts and 120 to Baystate--is expected to open in August 2023. Baystate holds 49% ownership of the hospital.

Volume generally improving, but staffing challenges remain

Many volume metrics improved in 2022 despite staffing pressures. Overall, management has navigated this well but expenses have increased dramatically to recruit and retain enough staff, particularly nurses to meet demand, and this has pressured margins. Given its key role as a safety net provider, Baystate remained staffed with all services open, even though this came at a high cost relative to labor, because several nearby hospitals were unable to remain fully open. Baystate traditionally maintains strong physician relationships, employing more than 1,000 providers and utilizing co-management and professional service agreements, leaving only a few remaining nonaffiliated physicians in the market.

Offsetting some staffing pressure is Baystate's status as the only regional campus for the University of Massachusetts Medical School. We believe that having the University's medical students and residents in the hospital will help support future physician and nursing recruitment efforts.

Table 1

Baystate Health System and subsidiaries utilization

	--Three months ended Dec. 31--	--Fiscal year ended Sep. 30--		
	2022	2022	2021	2020
PSA population	N.A.	695,305	699,162	N.A.
PSA market share (%)	N.A.	N.A.	N.A.	62.3
Inpatient admissions*	12,328	48,353	47,645	43,674
Equivalent inpatient admissions	31,309	120,069	117,699	107,233
Emergency visits	40,607	183,474	166,612	172,272
Inpatient surgeries	1,940	8,272	9,212	10,238
Outpatient surgeries	6,875	24,420	24,313	21,838
Medicare case mix index	1.6837	1.7138	1.7042	1.7837
FTE employees	8,327	8,269	7,980	7,850
Active physicians	1,633	1,630	1,774	1,603
Medicare (%)§	42.9	42.4	43.3	41.5
Medicaid (%)§	20.7	20.4	18.9	20.0
Commercial/Blues (%)§	32.2	32.9	33.3	34.6

*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: Strong

Margins worsen as a result of expense pressures with improvement expected in outlook period

Fiscal 2022 operational performance remained weak as a result of pandemic-related pressures, including elevated labor and supply expenses and longer hospital stays. For fiscal 2023 management has budgeted for a 1.3% operating margin, which would be more in line with pre-pandemic operating performance, although with reliance on pandemic relief funds. While we believe the budget is achievable, given historical operating performance, Baystate's ability to meet budget hinges on whether the hospital will experience additional unanticipated labor and wage pressures. Management reports that a longer-term goal of a 2%-3% operating margin is needed to fund long-term capital goals.

While Baystate's margins have typically been below medians, they have historically been stable and reliably generated healthy debt service coverage, which has returned in the interim period. We view a return to this stability and historical coverage as important for rating maintenance.

Management focused on increasing revenue and managing costs

Following a period of negative operations and in the context of ongoing industrywide labor and wage pressures, Baystate management has engaged outside consultants to assist in identifying revenue-generating and cost-saving initiatives of $40 million to $50 million over the next five years. Baystate has been addressing staffing and wage expense pressures, but vacancies remain elevated and future wage adjustments might be necessary. In addition, length of stay remains an issue for the hospital and management is focused on enhancing throughput. Opportunities for improvement include information technology investment in revenue cycle, resizing of span of control, growth in the orthopedic ambulatory business through a joint venture, and rate increases.

Balance sheet growth is also possible, as Baystate has reached the end of its material strategic capital spending with completion of the surgical project and expects lower spending through the outlook period. Furthermore, management reports that HNE is break-even on financial results and is performing well relative to the risk associated with operating a small health plan after pulling back on certain unprofitable business segments. Management attributes performance to benefits from the Medicaid waver partly offset by lower and less profitable commercial enrollment. In addition, Baystate has raised $30 million toward a $55 million capital campaign.

Pressured balance sheet offers limited cushion

Following growth in key balance sheet metrics such as days' cash on hand and unrestricted reserves in recent years, nearly all of Baystate's key unrestricted reserve metrics have declined and are light for the rating with the exception of capital expenditures to depreciation and amortization following completion of its recent construction project. While we believe the presence of the health plan and the employed physician group practice somewhat dilute the days' cash ratio, levels are now less than half of rating medians.

Partly offsetting Baystate's pressured unrestricted reserves is the hospital's moderate debt, although most of the hospital's debt is classified as contingent (variable-rate or direct-purchase transactions), which we view unfavorably, as it is associated with additional risk. However, partly offsetting factors to this risk include a diversified portfolio of four banks, unrestricted reserves at about 1.6x total contingent liabilities, ample headroom above covenants (typically 1.1x debt service coverage and 50 to 80 days' cash on hand), and market access with a strong investment-grade rating. In addition, most of the bank loans are fixed-rate, amortizing, and have 10-year or longer maturities. The system has no additional debt plans.

Furthermore, Baystate's defined benefit pension plan has been closed to new participants since 2005, and we consider it to be very well funded. More recently, management has de-risked the pension and expects to transfer the liability off its books within the next 8 to 12 months.

Table 2

Baystate Health System and subsidiaries financial summary

	--Three months ended Dec. 31--	--Fiscal year ended Sept. 30--			'A' rated health care system medians
	2022	2022	2021	2020	2021
Financial performance					
Net patient revenue ($000s)	446,915	1,678,943	1,650,541	1,439,513	3,301,950
Total operating revenue ($000s)	795,380	2,843,593	2,744,930	2,481,359	3,511,073

Table 2

Baystate Health System and subsidiaries financial summary (cont.)

	--Three months ended Dec. 31--	--Fiscal year ended Sept. 30--			'A' rated health care system medians
	2022	2022	2021	2020	2021
Total operating expenses ($000s)	772,253	3,028,683	2,750,172	2,457,813	3,371,951
Operating income ($000s)	23,127	(185,090)	(5,242)	23,546	82,687
Operating margin (%)	2.91	(6.51)	(0.19)	0.95	1.90
Net nonoperating income ($000s)	(7,188)	155,080	25,012	2,942	69,765
Excess income ($000s)	15,939	(30,010)	19,770	26,488	139,808
Excess margin (%)	2.02	(1)	0.71	1.07	4.00
Operating EBIDA margin (%)	5.75	(3.41)	2.95	4.67	6.90
EBIDA margin (%)	4.90	1.93	3.82	4.79	9.00
Net available for debt service ($000s)	38,583	57,998	105,916	118,908	378,589
MADS ($000s)	37,911	37,911	37,911	37,911	81,381
MADS coverage (x)	4.07	1.53	2.79	3.14	4.40
Operating-lease-adjusted coverage (x)	3.13	1.37	2.18	2.39	3.30
Liquidity and financial flexibility					
Unrestricted reserves ($000s)	875,014	879,920	1,129,263	1,067,969	1,834,266
Unrestricted days' cash on hand	106.1	108.9	154.1	163.9	187.8
Unrestricted reserves/total long-term debt (%)	151.6	151.6	218.9	192.5	161.1
Unrestricted reserves/contingent liabilities (%)	164.1	164.1	231.3	214.7	605.3
Average age of plant (years)	17.4	17.8	18.8	17.0	12.1
Capital expenditures/depreciation and amortization (%)	167.7	171.1	146.0	70.5	110.7
Debt and liabilities					
Total long-term debt ($000s)	577,120	580,441	515,868	554,923	1,353,718
Long-term debt/capitalization (%)	38.0	39.5	28.8	35.5	35.6
Contingent liabilities ($000s)	533,284	536,210	488,262	497,480	293,033
Contingent liabilities/total long-term debt (%)	92.4	92.4	94.6	89.6	26.2
Debt burden (%)	1.20	1.26	1.37	1.53	2.00
Defined benefit plan funded status (%)	N.A.	95.21	103.14	88.79	84.80
Miscellaneous					
Medicare advance payments ($000s)*	0	0	171,442	221,639	MNR
Short-term borrowings ($000s)*	0	0	0	0	MNR
COVID-19 stimulus funding recognized ($000s)	53,784	48,049	68,509	107,356	MNR
Risk-based capital ratio (%)	N.A.	305.12	297.69	391.78	MNR
Total net special funding ($000s)	14,047	17,715	22,052	20,175	MNR

*Excluded from unrestricted reserves, long-term debt, and contingent liabilities. MADS--Maximum annual debt service. MNR--Median not reported. N.A.--Not available.

Credit Snapshot

- Group rating methodology: Core
- Organization description: BMC's parent company, Baystate Health, is an integrated delivery system serving western Massachusetts. Its flagship, 780-bed BMC, serves the Springfield region as the sole tertiary provider and academic medical center. The system also operates three local community hospitals (68-bed Baystate Wing Hospital, 85-bed Baystate Noble Hospital, and 89-bed Baystate Franklin Medical Center), a nonprofit health plan (NHE), Baystate Medical Practices (a multispecialty group practice employing over 1,000 providers), a visiting nurse association, charitable foundation, and an off-shore captive insurance company.
- Swap: Baystate is a party to just one swap with a notional amount of $17.4 million and a mark-to-market of negative $90,921 on Dec. 31, 2022, with no collateral posted.

Related Research

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