S&P Global
Ratings

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Oklahoma Development Finance Authority
OU Medicine Inc.; Hospital

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Unenhanced Rating	BB-(SPUR)/Stable	Affirmed

Many issues are enhanced by bond insurance.

Credit Highlights

- S&P Global Ratings revised its outlook to stable from negative and affirmed its 'BB-' long-term rating on the Oklahoma Development Finance Authority's series 2018B tax-exempt fixed-rate bonds and series 2018C taxable fixed-rate bonds, issued for OU Medicine Inc. (OUMI), now doing business as OU Health.
- In addition, we affirmed our 'BB-' underlying rating (SPUR) on the insured maturities of the authority's series 2018B and 2018C bonds, also issued for OUMI.
- The outlook on all ratings, where applicable, is stable.
- The stable outlook reflects our view that the financial profile has largely stabilized, with no further declines in year-end unrestricted reserves or added debt expected. In addition, despite immense sector labor and inflationary pressures, operations remained fairly resilient in fiscal 2023 supporting projected year-end debt service coverage of 1.5x. Management also notes compliance with its 45 days' cash on hand (DCOH) covenant for fiscal 2023, with further reserve tailwinds expected in fiscal 2024 given greatly reduced capital spending and increased Medicaid reimbursement under a new rate enhancement program.

Security

Unrestricted receivables of OU Health, as the only member of the obligated group, secure the bonds along with a mortgage on certain assets. The unrated $175 million of subordinate debt is not issued under the master trust indenture (MTI), and principal and interest payments are made when certain financial metrics and ratios are achieved.

Credit overview

The rating reflects our view of OU Health's still highly vulnerable financial profile given its weak cash levels relative to both operations and long-term debt, coupled with its highly elevated leverage position inclusive of $150 million in additional debt issued last summer to shore up reserves and help finance the system's new IT system that launched in June 2023. Though the initial launch has gone well thus far and we believe the merits of this IT investment are clear, it introduces some risks to the credit profile over the coming months including expected cash and accounts receivable volatility.

Somewhat mitigating these factors, the rating is supported by the system's strong position as the region's academic health system, including the state's only Level I trauma center, comprehensive children's hospital, and National Cancer Institute (NCI)-designated cancer center. The system covers a large service area with referrals from across the state, albeit operating within the competitive Oklahoma City market. The enterprise profile is further bolstered by proven support from the state, as well as the July 2021 integration of OU Physicians, the school's faculty practice group, into OU Health from the University of Oklahoma Health Sciences Center (OUHSC).

We believe the system has managed sector expense pressures well, with just moderate operating losses expected by year-end 2023 aided by declining contract labor spending, strong volumes generally above pre-pandemic levels, and increased specialty pharmacy and 340B utilization. We also believe as presented results mask some underlying improvement from the prior year, given fiscal 2022 included one-time gains such as stimulus funding and a $25 million payment from the University of Oklahoma related to the integration of OU Physicians. Moreover, fiscal 2023 includes resumed mission support payments to OUHSC after a pause in 2022. Management is budgeting for a breakeven fiscal 2024 and we believe this is achievable given the aforementioned operating momentum, as well as a $96 million state appropriation to support indigent care; the budget excludes material benefits from the state's new rate enhancement program expected to commence in the final quarter or early fiscal 2025. We believe the system's unique and tight relationship with the state, University Hospitals Authority and Trust (collectively referred to as UHAT), and the University of Oklahoma supports the credit profile, with several tangible and material examples of this support over the past year.

We expect the system's balance sheet to remain constrained over the outlook period, but note increasing flexibility as operating earnings improve and capital spending falls to routine levels following years of elevated investment including a 144-bed inpatient tower on its flagship University of Oklahoma Medical Center (OUMC) campus and the new electronic medical record and revenue cycle IT system.

The 'BB-' rating further reflects our view of OU Health's:

- Very light unrestricted reserves of about 37 DCOH as of March 31, 2023, though this is up from the same period of the prior year and was above covenant thresholds at year-end per management;
- Highly leveraged balance sheet, with about 86% long-term debt to capitalization, with slower principal amortization structured;
- Longer-term pressures on cash growth given elevated interest payments, senior debt principal payments beginning in fiscal 2023, and subordinate debt service payments triggered as cash grows;
- Thin but sufficient debt service coverage at 1.4x in interim fiscal 2023, coupled with negative operating results and substantial supplemental funds from the state, although we view these state funds as less vulnerable to changes given their incorporation into legislation; and
- Highly competitive local market, including INTEGRIS Health and other multistate systems.

Partly offsetting the weaknesses, in our view, are OU Health's:

- Improvement in DCOH at year-end 2023 supporting covenant compliance, aided by about $41 million in American Rescue Plan Act (ARPA) funds and a $67 million supplemental funding payment;
- Solid business position, with about 18% market share and a close relationship with the state and OUHSC as the primary academic health system in Oklahoma, driving solid demand, particularly for tertiary and quaternary services;
- Material financial benefit from the state's expansion of Medicaid coverage, coupled with expected gains from the imminent rate enhancement program over the outlook period;
- No defined-benefit pension plan exposure, coupled with all unrestricted reserves currently held in cash or cash equivalents; and
- Stabilized management team with all roles filled by interim leaders at last review now held with full-time executives.

Environmental, social, and governance

With the stabilization of the executive leadership team and generally improving financial outlook, we consider governance risks as neutral in our credit rating analysis. Roles held by interim leaders at last review included chief operating officer, chief nursing officer, and chief human resources officer. The team is under the direction of President and CEO Dr. Richard Lofgren, who assumed CEO duties in March 2022, having previously served in the same capacity at UC Health in Cincinnati since 2013. OU Health is governed by a unique joint operating agreement structure between University Hospitals Trust (UHT), a component of the University Hospitals Authority (the authority), and OU Health. UHT and the authority (collectively referred to as UHAT) combine to form a consolidated component unit of the state, while OU Health is a separate 501(c)(3) whose sole member is UHT.

We view social risk as a neutral factor to the credit rating analysis, though we also recognize additional human capital risks tied to higher labor and salary pressures within the sector that are expected to persist through the outlook period. We believe environmental risks are also a neutral factor to the credit rating analysis despite the service area's propensity for extreme weather events.

Outlook

The stable outlook reflects our belief that OU Health's financial profile will not deteriorate from current levels, with incremental improvement in operating performance and unrestricted reserves expected in fiscal 2024. The stable view is also underpinned by our expectation for full financial covenant compliance and continued strong support from the state.

Downside scenario

We could lower the rating if unrestricted reserves decline from current levels, or if operating losses widen such that coverage is below 1.0x. Violation of financial covenants could also necessitate a lower rating. A need for external financing to support operations or spending, or sustained increases in accounts payable, could also be indicative of a lower rating.

Upside scenario

A positive outlook would require improved operating cash flow and year-end cash growth, coupled with successful IT system implementation. We would also expect stability among the leadership team, including both management and governance, and no additional debt. While we believe OU Health's high debt load requires incrementally more cash and operating stability as an offset, we also believe the system's enterprise profile can support a higher rating over time.

Credit Opinion

Enterprise Profile--Strong

Solid market position and evolving strategy in a competitive service area

We view the market as competitive, with OU Health having about 18% market share in its eight-county primary service area and INTEGRIS Health, with several facilities across the service area, having the leading market share. Mercy Health and SSM Health, both based in Missouri, have market share below that of OU Health. We expect competition to remain strong in the area, but believe there could be longer-term market share upside as the system is able to fully staff its existing clinical capacity.

Despite OU Health not having the leading market share, we view it as having a unique market position as the academic health system for the region. OU Health's key programs include trauma, neurosurgery, cancer, and pediatrics and since 2018 and as a fully independent facility, OU Health has implemented several significant strategic actions to increase its strength in the market, including its new patient tower, as well as continued investment in physicians, key service lines, and access points, such as multiple urgent-care/emergency department hybrid clinics. OUMC provides many of the highly acuity services in the service area and region, as reflected by the Medicare case mix index of well over 2.000.

OU Health is the main partner of separately governed OUHSC, which previously housed OU Physicians, the state's largest physician group. Those physicians are now part of OU Health Partners, the exclusive physician enterprise of OU Health and medical practice plan for faculty; active physicians now exceed 1,000. OUHSC also includes the NCI-designated Stephenson Cancer Center, which brings research and clinical trial benefits for both OUHSC and OU Health. In January 2023, the system announced an oncology partnership with Norman Regional Health System (20 miles south of Oklahoma City) and we expect OU Health to pursue additional similar affiliations across the state in the future.

Higher governmental payor mix offset by state support, added Medicaid reimbursement

OU Health's payor mix is modestly concentrated with governmental payors, but this reflects Oklahoma Children's Hospital, as well as its status as an academic health system and safety net provider of essential services. Oklahoma expanded Medicaid eligibility effective July 1, 2021, and this has materially benefitted OU Health given its outsized care of the region's Medicaid population, particularly those with higher acuity and cost. In addition, partly offsetting the high concentration of governmental payor mix is OU Health's receipt of significant supplemental funds, totaling a net $234 million for fiscal 2022 when also including disproportionate share funds. State funds largely come through a program designated for Level I trauma centers called the Teaching Hospital Reimbursement Program (THRP). This program is unique to OU Health within the state, and OU Health does not participate in the state's broader provider tax program (SHOPP). In addition, as part of the state's transition to Medicaid managed care, a rate enhancement program based on average commercial rates is expected to become effective in spring/summer 2024. Management estimates a net benefit of $100 million to $140 million annually, though nothing has been included in the fiscal 2024 budget. We believe this reimbursement change could accelerate financial profile improvement over the coming years and help mitigate ongoing expense inflation.

Table 1

OU Health, Oklahoma--enterprise statistics

	--Nine months ended March 31--	--Fiscal year ended June 30--		
	2023	2022	2021	2020
PSA population	N.A.	1,532,913	1,531,699	1,486,822
PSA market share (%)	N.A.	N.A.	N.A.	N.A.
Inpatient admissions	27,663	34,850	32,197	33,404
Equivalent inpatient admissions	46,197	57,154	53,155	53,757
Emergency visits	83,248	104,862	84,956	101,970
Inpatient surgeries	9,331	12,151	11,771	11,721
Outpatient surgeries	14,711	18,912	18,288	17,817
Medicare case mix index	2.2100	2.2200	2.2600	2.0200
FTE employees	5,671	5,392	5,286	4,700
Active physicians	1,002	860	927	905
Based on net/gross revenues	Gross	Gross	Gross	Gross
Medicare (%)	27.5	28.4	29.2	28.5
Medicaid (%)	35.4	32.6	24.6	25.5
Commercial/Blues (%)	26.4	27.4	24.3	27.4

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

Financial Profile--Highly Vulnerable

Performance remains negative but stable, improvement expected from added Medicaid reimbursement

Following below expectation results beginning near the conclusion of fiscal 2021, largely driven by the launch of OUMC's new patient tower and its compounding effect on existing labor challenges, operations have generally remained stable albeit negative. The system has posted a $21.9 million operating loss through the first nine months of fiscal 2023, slightly weaker than the prior year, reflective of reduced stimulus funding and the resumption of annual mission support payments to OUHSC after a pause in fiscal 2022; these payments are expected to total around $30 million annually, with an inflator based on hitting EBIDA targets. In addition, fiscal 2022 results included a $25 million payment from the University of Oklahoma to offset initial operating losses from OU Physicians. In the aggregate, we view interim 2023 results favorably and expect a consistent year-end.

Management is budgeting for breakeven in fiscal 2024, inclusive of a $96 million state appropriation to support indigent care, but excluding material benefits from the state's new rate enhancement program; we view this target as realistic. ARPA funds expected from UHAT are not anticipated to materially improve the income statement given the majority will be recognized for capital purposes. Longer-term performance tailwinds include greater synergies and integration with OU Health Partners, such as greater utilization of hospital-based billing and the 340B program, as well as strong patient demand that should be captured with more stable staffing.

OU Health has some moderate flexibility as it relates to timing of payments on its subordinate debt, but we fully incorporate that debt service into our maximum annual debt service (MADS) coverage calculation, which remains light but sufficient at about 1.4x through interim 2023. We expect coverage covenant compliance in fiscal 2023.

Unrestricted reserves remain light, but slightly improved

Unrestricted reserves at OU Health relative to both long-term debt and operating expenses are very light, though the 37 DCOH as of March 31, 2023, compares favorably with 21 days the same period of the prior year. We expect incremental growth in unrestricted reserves, albeit with some declines possible in the early quarters of fiscal 2024 as the revenue cycle is temporarily affected by the IT system implementation. OU Health as maintains a $75 million line of credit which matures March 2028.

We expect the system will remain in compliance with its 45 days' cash on hand covenant in fiscal 2023 when formally assessed. Management indicates compliance was supported by the receipt of $41 million in ARPA funds from UHAT to reimburse a portion of the IT system project, as well as a $67 million THRP payment from UHAT which is typically paid in June

We believe medium term unrestricted reserves will be supported by the completion of major capital projects with only routine spending forecasted for fiscal 2024, near 55% of depreciation expense; this could be further supported by stronger earnings aided by the rate enhancement program if implemented as contemplated; a possible one-time 340B settlement could also aid cash over the coming quarters. Over the longer-term, we believe robust unrestricted reserve growth will be challenged given the onset of principal payments on senior debt and OU Health's all cash investment allocation, though the latter is a critical risk management tool given the system's lighter liquidity.

High debt load remains credit risk

OU Health maintains a significantly leveraged balance sheet, with a total of $1.5 billion of long-term debt, including $175 million of subordinate debt and $150 million of new debt issued in calendar 2022. The system's highly levered balance sheet remains a principal credit weakness, though we recognize the accounting treatment related to the acquisition financing of assets by OU Health also contributes to the very high leverage by way of limiting net assets. Debt burden has improved dramatically in recent years given strong total revenue growth, though it remains on the higher side.

Management has no additional debt plans at this time. Despite this, we believe material movement in leverage will take several years. We consider the $100 million series 2022A private placement debt to be contingent given it contains additional financial covenants, including a 40 days' cash on hand event of default threshold effective in fiscal 2026, compared with 35 days in the MTI.

The $251 million series 2018C taxable bonds consist of bullet payments in fiscal years 2029 and 2031 that will likely be refinanced and considered contingent by S&P Global Ratings once their maturity is within five years. The terms of the subordinate debt interest and principal payments are what we view as flexible in the near term, with principal and interest only due when operating liquidity surpasses certain thresholds (85 days' cash on hand for interest, 125 days for principal), but the debt is due in December 2032 regardless of underlying liquidity.

Table 2

OU Health, Oklahoma--financial statistics					
	--Nine months ended March 31--	--Fiscal year ended June 30--			Medians for speculative-grade rated stand-alone hospitals
	2023	2022	2021	2020	2021
Financial performance					
Net patient revenue ($000s)	1,419,218	1,754,333	1,339,942	1,237,012	178,450
Total operating revenue ($000s)	1,622,256	1,944,361	1,415,589	1,298,147	217,105
Total operating expenses ($000s)	1,644,160	1,957,465	1,442,542	1,258,000	238,111
Operating income ($000s)	(21,904)	(13,104)	(26,953)	40,147	4,475
Operating margin (%)	(1.35)	(0.67)	(1.90)	3.09	1.50
Net nonoperating income ($000s)	2,964	(1,267)	(732)	6,705	1,485
Excess income ($000s)	(18,940)	(14,371)	(27,685)	46,852	6,228
Excess margin (%)	(1.17)	(0.74)	(1.96)	3.59	3.10
Operating EBIDA margin (%)	5.12	5.92	6.65	11.67	6.70
EBIDA margin (%)	5.29	5.86	6.60	12.12	8.80
Net available for debt service ($000s)	85,944	113,818	93,443	158,154	17,867
Maximum annual debt service ($000s)	81,856	81,856	81,856	81,856	7,340
Maximum annual debt service coverage (x)	1.40	1.39	1.14	1.93	2.40
Operating lease-adjusted coverage (x)	1.26	1.26	1.11	1.73	2.10
Liquidity and financial flexibility					
Unrestricted reserves ($000s)	215,085	236,758	186,399	341,021	56,252
Unrestricted days' cash on hand	36.9	45.5	49.1	102.9	112.2
Unrestricted reserves/total long-term debt (%)	14.3	16.7	13.6	24.8	78.5
Unrestricted reserves/contingent liabilities (%)	215.1	N/A	N/A	N/A	333.9
Average age of plant (years)	4.3	3.9	3.0	2.3	14.1
Capital expenditures/depreciation and amortization (%)	188.6	238.4	290.6	427.1	79.1
Debt and liabilities					
Total long-term debt ($000s)	1,502,579	1,417,965	1,375,248	1,375,454	81,344
Long-term debt/capitalization (%)	86.3	85.3	86.1	85.3	47.0
Contingent liabilities ($000s)	100,000	0	0	0	10,000
Contingent liabilities/total long-term debt (%)	6.7	0.0	0.0	0.0	13.6
Debt burden (%)	3.78	4.21	5.79	6.27	2.90
Defined-benefit plan funded status (%)	N/A	N/A	N/A	N/A	80.30

Table 2

OU Health, Oklahoma--financial statistics (cont.)					
	--Nine months ended March 31--	--Fiscal year ended June 30--			Medians for speculative-grade rated stand-alone hospitals
	2023	2022	2021	2020	2021
Miscellaneous					
Medicare advance payments ($000s)*	0	27,000	91,000	101,000	MNR
Short-term borrowings ($000s)*	N/A	N/A	N/A	N/A	MNR
CARES Act grants recognized ($000s)	2,496	26,000	31,000	48,000	MNR
Total net special funding ($000s)	205,002	234,429	168,488	160,265	MNR

*Excluded from unrestricted reserves, long-term debt, and contingent liabilities. N/A--Not applicable. MNR--Median not reported.

Credit Snapshot

- Group rating methodology: OU Health accounts for the vast majority of assets and revenue of the system, and, accordingly, we consider them core to the group credit profile.
- Key covenants: OUMI must maintain at least 45 days' cash on hand and attain annual debt service coverage on senior debt of 1.1x. Days' cash on hand below 35 is an event of default.
- Organizational profile: OU Health owns and operates University of Oklahoma Medical Center, a 433-staffed bed academic medical center in Oklahoma City, along with Edmond Medical Center, about 15 miles north of OUMC with 66 staffed beds. OUMI also leases and operates the 341-staffed-bed Oklahoma Children's Hospital and owns and operates clinics, imaging, and other health-related services across the service area. OUMC and Oklahoma Children's Hospital are on the same campus as the OUHSC, the state's main health sciences education and research facility. University Hospitals Trust, a public entity that, together with another public entity, University Hospitals Authority, is known as UHAT, remains OU Health's sole corporate member but is not obligated on its debt.

Related Research

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