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## North Broward Hospital District, Florida; System

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# North Broward Hospital District, Florida; System

## Credit Profile

North Broward Hospital District rev bnds ser 2017B due 07/01/2047

*Long Term Rating*

BBB+/Stable

Outlook Revised

## Rationale

S&P Global Ratings revised its outlook to stable from negative and affirmed its 'BBB+' rating on North Broward Hospital District (doing business as Broward Health), Fla.'s series 2017B health care revenue bonds.

The outlook revision to stable reflects Broward Health's manageable level of operating losses especially given its solid liquidity and financial flexibility; and conservative all fixed-rate debt structure. While we still believe that continued instability at the senior management level remains a concern, including the October 2018 resignation of CEO Beverly Capasso, and the termination of its general counsel, the increased risk associated with governance and management turnover is fully factored into the enterprise profile assessment at the current rating level. The board acted quickly in naming a replacement CEO, choosing the chief operating officer of the system, as well as making some other internal management changes. We continue to believe that these appointments are critical to implementing and sustaining operational improvements and outlining the strategic direction of the organization, while establishing accountability throughout the system. While we view the recent appointments as a continuation of the existing strategy, we believe a longer period of stability and demonstrated track record of improvement is necessary before considering a higher rating.

The 'BBB+' rating reflects a financial profile that remains consistent with the rating despite some ongoing operating losses, coupled with an enterprise profile that has weakened over the past several years. While we believe Broward Health maintains some financial metrics consistent with a higher rating, including a solid liquidity and financial flexibility, we remain in the 'BBB' category due to issues surrounding corporate compliance and continued evolving permanent senior leadership team, although some key roles have been filled with experienced executives.

Broward Health is operating under a corporate integrity agreement (CIA) following the August 2015 settlement (approximately \$70 million) with the Department of Justice related to various Stark Law and False Claims Act allegations. As noted in the fiscal 2018 audited statements, subsequent to filing the district's second annual report to the Office of Inspector General (OIG), Broward Health disclosed on May 23, 2018 a probable violation of the Stark Law, which was reported through the voluntary self-referral disclosure protocol. In addition, on May 30, 2018 the District reported a probable violation of the Sherman Act and Federal Trade Commission Act and is currently responding to additional information requested by the FTC. According to management, the amount of penalties, if any, cannot be determined at this time. While we view favorably the self-reporting of these potential violations, we remain concerned that these compliance issues may still exist. We will continue to monitor any future developments with respect to the ongoing CIA, and will incorporate any potential negative judgements or violations, if applicable, into our rating analysis.

Other factors that preclude a lower rating include Broward Health's still strong balance sheet, with good liquidity and financial flexibility for the rating level, its essential role in Broward County and the flexibility provided by the unused tax millage should operations remain stressed over a sustained period of time.

The rating also reflects our assessment of Broward Health's:

- Slightly leading market position in its highly competitive primary service area of the northern two-thirds of Broward County with a 34% primary market share (calendar year 2017), although down from 37% several years ago (2014) and could experience a further decline based on the challenging business volume trend;
- Still solid balance sheet highlighted by strong days' cash on hand, unrestricted reserves to debt, and light debt levels; and
- Significant tax millage receipts combined with decreasing millage rates enhancing overall flexibility as the board has the ability to raise millage rates higher, which could prove valuable should operating performance remain pressured.

Offsetting rating factors include Broward Health's:

- Slight deficit operating performance through the six month period ended Dec. 31, 2018, while fiscal 2018 operating results were relatively breakeven after adjusting for a \$68.9 million one-time decrease in other postemployment benefit costs;
- Another change in key senior management roles, which highlights continued turnover and instability for several years, although the latest changes are a mix of internal appointments and external hires that appear to be continuing with the same organizational strategy that began almost two years ago; and
- Physician turnover issues resulting in weaker business volume trends in fiscal 2018 and fiscal 2019 interim year to date.

## **Outlook**

The stable outlook reflects our expectation that Broward Health will continue to address operating and organizational challenges as they remain an essential health care provider in Broward County. Operating performance, while still challenged due to volume pressure, is offset by Broward Health's solid balance sheet for the rating level coupled with unused tax millage capacity, providing ample flexibility as management implements key performance improvement measures.

### **Downside scenario**

We could consider a lower rating if there were sustained weaker financial results or pressure on key balance sheet metrics. Furthermore, we could also lower the rating if Broward Health cannot maintain stable permanent senior leadership such that it continues to negatively affect the systems overall enterprise profile through either an inability to execute its strategic plan or reputational harm that results in business volume loss and subsequent market share decline. The ongoing CIA requires a higher level of compliance and risk management, and as such, an unfavorable finding or non-compliance could have negative rating implications.

## **Upside scenario**

We could revise the outlook to positive or raise the rating over the two-year outlook period if the newly appointed senior management team successfully implements operational improvements and shapes the strategic direction of the organization, while establishing accountability throughout the system. Some key factors that would be viewed favorably include successful physician recruitment, sustained improvement in business volumes and underlying operating performance more in line with historical trends; resolution of the uncertainty surrounding ongoing investigations and self disclosures under the CIA, identifying a permanent CEO; and fully attesting to and remaining in compliance with all requirements of the CIA.

## **Enterprise Profile--Adequate**

### **Market position**

Broward Health's market share has varied over time but is experiencing some pressure of late, with a 33.5% share in its primary service, which is composed of the northern two-thirds of Broward County. Given its recent management, compliance and operational issues, we expect market share may decline in the coming year, especially given the physician turnover and significant competition from numerous providers including HCA Healthcare Corp.'s four facilities, and Memorial Healthcare System, also known as South Broward Hospital District. Three other providers including the Cleveland Clinic's Weston facility also compete with Broward Health. Inpatient admissions totaled 48,503 in fiscal 2018, down from 51,687 the prior year and below the 2011 peak of 65,379 inpatient admissions. While one of the contributing factors to the decline has been the growth in observation cases, the more troubling trend has been physician turnover and limited physician recruitment, which we believe is due in part to the enterprise and reputational issues of the past four years.

We believe the active competition remains a credit risk, as does the district's large share of the county's Medicaid population and charity care. Medicaid is roughly 20% of the gross payer mix and commercial insurance is 29%. As an independent taxing authority, Broward Health has authorization, through a future vote of its board of commissioners, to levy ad valorem taxes up to 2.5 mills. The revenue from the tax millage helps the district finance uncompensated care and other community benefit costs. The 2019 budgeted tax rate decreased to 1.0855, significantly below its 2.5 mill cap, which was last assessed at that limit in 2003-2004.

Broward Health's historically improved financial performance from fiscal 2008 to 2015, and the board's commitment to improve core operations, has allowed for the significant reduction in the tax millage over time. While the board only lowers the millage if it is economically feasible for the district, there may be some pressure to increase the millage in future years if operations remain stressed. The gross tax funds on the millage (net of associated fees) is estimated at \$136.8 million in fiscal 2019, down from \$147 million in fiscal 2018 and a peak of \$196.7 million in fiscal 2006, reflecting both the change in millage rate (as approved by the board) as well as changes in the underlying assessed valuation of homes in the tax district. If the board were to raise the millage to the maximum rate of 2.5 mills, the district could generate an additional \$175 million of gross revenue annually.

### **Management**

Broward Health is in a period of transition at the senior leadership level, having replaced another CEO after less than

one year in the role. The board appointed the then existing chief operating officer to the CEO role and moved the chief financial officer (CFO) into a chief administrative role. The CFO role was filled internally by the System's vice president of finance. In addition, a treasurer was hired from outside the organization, having a strong background in that role at another health system. As such, there has been some internal movement and external hires over the past six months, but management indicates the senior team is in place and executing on the key strategic goals of the organization.

In our opinion, the level of external scrutiny the organization has received over the past several years highlights the need for stable permanent leadership to navigate through the challenging period. We believe maintaining longer-term stability at the senior level will provide mid-level managers within the organization a disciplined strategy and greater accountability for their respective roles. In addition, we believe the necessary compliance concerns require a significant amount of senior management's time and effort, and are best handled by a stable and permanent senior leadership team.

**Table 1**

<b>North Broward Hospital District, Florida Enterprise Statistics</b>			
	<b>Four months ended Oct. 31</b>	<b>--Fiscal year ended June 30-- June 30--</b>	
	<b>2018</b>	<b>2018</b>	<b>2017</b>
Inpatient admissions	15,095	48,503	51,687
Equivalent inpatient admissions	35,467	109,869	115,172
Emergency visits	13,381	279,523	288,997
Inpatient surgeries	4,365	13,853	15,116
Outpatient surgeries	5,241	15,451	16,081
Medicare case mix index	1.7220	1.7500	1.7100
FTE employees	7,538	7,792	7,883
Active physicians	954	1,285	1,399
<b>Top 10 physicians admissions (%)</b>			
Based on net/gross revenues	Gross	Gross	Gross
Medicare (%)	35.0	37.0	33.3
Medicaid (%)	19.2	20.2	20.4
Commercial/Blues (%)	30.8	29.0	32.2

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

## **Financial Profile--Strong**

### **Financial performance**

Broward Health generated improved operating results in fiscal 2018, mainly due to a one-time \$68.9 million decrease in other postemployment benefit costs. If adjusted for the one-time cost reduction, underlying operations would be slightly relatively breakeven with a slight \$3.5 million gain (\$72.5 million gain when including the one-time cost reduction). Fiscal 2018 results comes on the heels of weaker operating results the prior two fiscal years, with a \$20.5 million (negative 1.76% margin) and a \$24 million (negative 2.1% margin) operating deficit in fiscal 2017 and 2016, respectively, compared with a \$45 million gain (3.9% margin) in fiscal 2015. The multi-year operating pressure is due

in part to several factors, including the loss of physicians and subsequent decline in business volume, continued competition for outpatient business including surgeries and ancillary services, the shifting payer mix to higher charity and self-pay, slightly weaker tax receipts reflecting the declining millage rate, and declines in disproportionate share revenue. Operating performance through the six month period ended Dec. 31, 2018, is tracking generally in line with budget, although net patient revenue is down 4.2% compared to budget and management has offset the declining revenue with expense reductions.

Excess income was stronger in fiscal 2018 at \$26.2 million even when excluding the one-time \$68.9 million expense reduction, generating strong adjusted coverage of MADS at 4.4x. Interim period excess results reflect the weak investment market performance through Dec. 31, 2018 as coverage of MADS was much weaker. Debt levels remain light with a debt burden of 2% and debt of roughly 29% of capitalization.

### Liquidity and financial flexibility

Broward Health's unrestricted reserves declined in fiscal 2016, in large part due to the \$70 million that was paid as part of the Stark Law and False Claims Act settlement; and remained relatively stable in fiscal 2017. As a result, days' cash on hand went from 246 in fiscal 2015 to 183 in fiscal 2016, and then up a few days to 186 in fiscal 2017. However, the series 2017B financing included some reimbursement to the balance sheet, which drove up days' cash to just 249 days in fiscal 2018, which we consider strong for the rating. Unrestricted reserves to debt is also considered strong at 208%, but down from previous highs due to the cash settlement and the additional debt.

Broward Health's series 2017B financing refunded all of the then variable rate debt outstanding. As such, Broward Health does not have any contingent debt outstanding. The current debt structure is viewed favorably as it removed the risk of potential bond acceleration or put risk due to a failed bond remarketing or potential covenant default.

**Table 2**

North Broward Hospital District, Florida Financial Statistics				
	--Six months ended Dec. 31--	--Fiscal year ended June 30--		
	2018	2018	2017	2016
<b>Financial performance</b>				
Net patient revenue (\$000s)	485,310	954,152	950,917	941,849
Total operating revenue (\$000s)	587,469	1,174,138	1,163,217	1,151,308
Total operating expenses (\$000s)	595,643	1,101,682	1,183,664	1,175,402
Operating income (\$000s)	(8,174)	72,456	(20,447)	(24,094)
Operating margin (%)	(1.39)	6.17	(1.76)	(2.09)
Net nonoperating income (\$000s)	(25,894)	22,680	20,794	38,051
Excess income (\$000s)	(34,068)	95,136	347	13,957
Excess margin (%)	(6.07)	7.95	0.03	1.17
Operating EBIDA margin (%)	4.76	12.27	3.63	2.99
EBIDA margin (%)	0.37	13.93	5.33	6.09
Net available for debt service (\$000s)	2,084	166,762	63,049	72,470
Maximum annual debt service (\$000s)	22,265	22,265	22,265	22,265
Maximum annual debt service coverage (x)	0.19	7.49	2.83	3.25
Operating lease-adjusted coverage (x)	0.38	5.46	2.27	2.78

Table 2

	--Six months ended Dec. 31--		--Fiscal year ended June 30--	
	2018	2018	2017	2016
<b>Liquidity and financial flexibility</b>				
Unrestricted reserves (\$000s)	755,330	714,067	575,071	563,289
Unrestricted days' cash on hand	242.6	248.7	185.7	182.7
Unrestricted reserves/total long-term debt (%)	220.1	207.7	272.8	252.6
Unrestricted reserves/contingent liabilities (%)	N.A.	N.A.	273.2	253.1
Average age of plant (years)	17.3	17.3	16.4	16.9
Capital expenditures/depreciation and amortization (%)	N.A.	133.0	168.4	172.0
<b>Debt and liabilities</b>				
Total long-term debt (\$000s)	343,113	343,874	210,819	222,972
Long-term debt/capitalization (%)	29.0	28.2	19.7	21.1
Contingent liabilities (\$000s)	0	0	210,475	222,525
Contingent liabilities/total long-term debt (%)	0.0	0.0	99.8	99.8
Debt burden (%)	1.98	1.86	1.88	1.87
Defined-benefit plan funded status (%)	N.A.	100.98	100.97	92.69

N/A--Not applicable. N.A.--Not available. MNR--Median not reported. Fiscal year 2018 operating surplus includes a one-time other postemployment benefit cost reduction of \$68.9 million, which if adjusted to reflect the non recurring nature, would result in relatively breakeven operations.

### Credit Snapshot

- **Organization:** Broward Health is a special taxing district created under Florida law that operates four hospitals with 1,359-staffed beds in the northern two-thirds of Broward County. The district's governing body is the board of commissioners, which consists of seven governor-appointed members serving staggered four-year terms. Broward Health operates four hospitals: Broward Health Medical Center, Broward Health North, Broward Health Imperial Point, and Broward Health Coral Springs. Broward Health also operates various outpatient centers in its service area in northern Broward County and employees 96 physicians (full-time equivalents), down from 109 in fiscal 2017.
- **Security:** The district's gross revenue pledge secures the bonds. The obligated group represents the majority of assets and revenues and is considered core under our group rating methodology.
- **Debt:** The \$317.25 million series 2017B fixed rate bonds is the only debt outstanding. Fiscal 2018 data is based on audited results, while the six month interim data is based on internal unaudited results ending Dec. 31, 2019. With the series 2017 debt issuance, Broward health replaced the old master trust indenture (MTI) with a new MTI, removing both the debt to capitalization and days' cash on hand covenants, but is still subject to a rate covenant. The changes to the MTI did not have any impact on the credit rating.

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