FitchRatings

15 OCT 2024

Fitch Ratings Assigns 'A' IDR on Thomas Jefferson University (PA), Rev Bonds; Outlook Stable

Fitch Ratings - Austin - 15 Oct 2024: Fitch Ratings has assigned its 'A' long-term rating on the following series of bonds, issued by, or on behalf of, Thomas Jefferson University, PA (TJU) aka Jefferson Health System:

--$635,425 million Pennsylvania Higher Educational Facilities Authority, PA tax-exempt fixed rate bonds, series 2024B-1;

--$300,000 million Pennsylvania Higher Educational Facilities Authority, PA tax-exempt fixed rate bonds, series 2024B-2;

--$167,650 million Pennsylvania Higher Educational Facilities Authority, PA taxable fixed rate bonds, series 2024C;

--$100,000 million Pennsylvania Higher Educational Facilities Authority, PA tax-exempt variable rate bonds, series 2024D-1;

--$100,000 million Pennsylvania Higher Educational Facilities Authority, PA tax-exempt variable rate bonds, series 2024D-2;

--$100,000 million Pennsylvania Higher Educational Facilities Authority, PA tax-exempt variable rate bonds, series 2024D-3; and

--$124,845 million Pennsylvania Higher Educational Facilities Authority, PA tax-exempt variable rate bonds, series 2024D-4.

Fitch Ratings has also assigned its 'A' long-term rating on the following series of bonds, issued by, or on behalf of TJU or Lehigh Valley Health Network, PA (LVHN) through various issuers:

--Lehigh County General Purpose Authority, PA series 2012B bonds;

--Lehigh County General Purpose Authority, PA series 2015A bonds;

--Pennsylvania Higher Educational Facilities Authority, PA series 2015B R-Float;

--Lehigh County General Purpose Authority, PA series 2016A bonds;

--City of Pottsville Hospital Authority series 2016B bonds;

--Monroe County Hospital Authority Hospital Revenue Bonds (Pocono Medical Center) series 2016;

--Philadelphia Authority for Industrial Development, PA series 2017A bonds;

--Philadelphia Authority for Industrial Development, PA series 2017B R-Float;

--Montgomery County Higher Education and Health Authority, PA series 2018A bonds;

--Montgomery County Higher Education and Health Authority, PA series 2018B taxable bonds;

--Montgomery County Higher Education and Health Authority, PA series 2018D R-Float;

--Montgomery County Higher Education and Health Authority, PA series 2019 bonds;

--Lehigh County General Purpose Authority, PA series 2019A bonds;

--Taxable series 2022A;

--Montgomery County Higher Education and Health Authority, PA series 2022B bonds;

--Issuer Default Rating (IDR)

The Rating Outlook is Stable.

The 'A' IDR and long-term bond ratings are supported by TJU's key credit strengths, which include the organization's strong and growing market position and as a nationally recognized provider of advanced specialty services in areas such as oncology, neurology, and cardiac care.

TJU is the leading provider of the inpatient market (approximately 28%) in Southeast, PA; and is the second leading provider in Southern, NJ (approximately 20%). The recent merger with LVHN, itself the leading provider in its primary service area (at approximately 48% inpatient market share) also opens up additional access to the more affluent and growing markets of Bucks and Berks counties.

TJU benefits significantly as both an academic medical center, but also as an educational university, with student enrolment demand staying robust, and of high quality, over the last several years. Total enrolment measures more than 8,300 students (many, but not all are affiliated with the health care industry), with more than 200 graduate and undergraduate programs, a solid 82% student retention rate, and over 77,000 alumni nationwide.

TJU also has over 2,100 medical residents, and over 125 post-doctoral students. The organization also benefits from being one of 57 National Cancer Institute (NCI) designated comprehensive cancer centers nationwide (the Sidney Kimmel Cancer Center), with access to significant research grants and contracts to support its clinical research programs. TJU has over 1,000 patents for new drugs, software innovation, medical devices and diagnostic tools.

TJU is uniquely positioned as a provider health system, a sizeable University with a considerable level of active research, and also has a 360,000 plus member health plan. Given this unique position, Fitch is of the opinion that TJU maintains appropriate balance sheet resources that equate to approximately 86.2% unrestricted cash to pro-forma debt, and approximately 98.4% total liquidity to pro-forma debt in fiscal 2024 (unaudited full year through June 30, 2024), should approximately $750 million of donor restricted endowment funds be included.

SECURITY

Bond payments are secured by a joint and several pledge of gross revenues of the obligated group. This financing creates a single credit/obligated group under the TJU Master Trust Indenture through the use of acquisition financing treatment and substitution of notes for outstanding LVHN debt.

KEY RATING DRIVERS

Revenue Defensibility - 'bbb'

TJU's revenue defensibility is assessed as mid-range, which is the most favorable assessment in the absence of meaningful taxing authority. Fitch defines revenue defensibility as an organization's ability to influence future reimbursement levels, which is generally limited for hospital providers, particularly over the short term. Revenue defensibility is also highly dependent on the payor mix, with Medicare, Medicaid and self-pay volumes resulting in a more restricted ability to influence near-term reimbursement.

TJU's legacy provider facilities operate in the highly competitive health care landscape within Philadelphia, PA. The system's payor mix is diverse, aligning closely with the demographics of the region. Approximately 57.4% of the hospital's gross revenue comes from Medicare (42.5%) and Medicaid (14.9%), reflecting the elderly and lower-income population in the area. Commercial payors account for about 36.5%, with the remaining 6.1% is derived from self-pay and other sources. LVHN's legacy provider facilities serve a broad and growing area in Lehigh Valley, PA. The payor mix for LVHN is similarly-balanced, with approximately 49.3% of revenues coming from Medicare, 16.1% from Medicaid, 31.1% from commercial insurers, and the remaining 3.5% from other sources. TJU's payor mix distribution reflects a mature and diverse patient base, providing some stability to the system's financial performance.

TJU holds a significant market share in its primary service area, commanding approximately 28% of inpatient admissions. TJU's strengths lie in its advanced specialty services and reputation for high-quality care in services such as oncology, neurology, and cardiac care, where it is recognized as a leader both regionally and nationally. TJU faces competition from other major health systems such as Penn Medicine and Temple University Hospital. LVHN commands a substantial market share in the Lehigh Valley region, capturing nearly 50% of inpatient admissions. Its strengths are particularly pronounced in areas such as trauma care, cardiovascular services, and cancer treatment. LVHN faces competition from St. Luke's University Health Network and several smaller community hospitals.

Philadelphia's health care market is robust, supported by a large and diverse population. The city boasts several academic medical centers and specialized hospitals, contributing to a high level of health care provision. One of the primary strengths of the service area is the presence of a well-established health care infrastructure and a population that values and seeks specialized medical care. The Lehigh Valley area has several strengths that support LVHN's operations. The region has experienced steady population growth, driven in part by its proximity to larger metropolitan areas like Philadelphia and New York City. This growth has led to increased demand for health care services, providing LVHN with opportunities to expand its patient base.

Philadelphia's unemployment rate, tends to be higher than the national average, and median household incomes lag behind state and national figures. Economic disparities result in a higher proportion of combined government and uninsured patients, which can strain hospital resources and impact financial margins without adequate management intervention. Additionally, the population growth in Philadelphia has been flat, limiting potential increases in patient volume save from demographic expansion, although the areas between TJU's and LVHN's service areas, particularly Bucks and Berks Counties, offer significantly enhanced demographics and population growth opportunities.

Operating Risk - 'bbb'

Although operations have been challenged over the past several years, Fitch anticipates that financial performance will recover over the next 24 months to 36 months and allow the organization to return to higher levels of operating margins and operating EBITDA margins (approximately 3.0% to 3.5% for the former, and approximately 7% to 8% for the latter. Building on recent operational success, TJU's experienced and capable senior management team believes that a successful integration of LVHN and TJU, could result in $255 million in recurring margin improvements once fully implemented.

In order to achieve these longer-term goals, management has been implementing an operational improvement plan, in addition to seeking out integration opportunities with LVHN and growth initiatives such as access to higher growth markets in Berks and Bucks counties, as well as in ambulatory settings. Initiatives include a mix of top-line revenue opportunities and expense management, including: labor productivity; increasing ambulatory access points and speed to clinician initiatives, in addition to revenue cycle and supply chain improvements. In particular, cancer services will remain a focus of TJU's growth strategy.

On its own, legacy TJU improved operations, and the quality of those earnings, in fiscals 2023 and 2024, with an average operating EBITDA of 1.9% (5.9% average EBITDA margin), improving from 1.0% in fiscal 2022. Note that Fitch does not include approximately $199 million in investment/endowment income in operations, which does push legacy TJU to just over a positive operating income. Investment/endowment income is captured with non-operating income, which is seen in EBITDA margins. LVHN has remained operationally profitable the last several years, seeing an operating EBITDA margin of 5.6% and an EBITDA margin of 7.0% in fiscal 2024. With the addition of the long profitable LVHN, expectations are for a more rapid ascent towards future sustainable profitability for TJU.

TJU's average spending has averaged 151% of annual depreciation over the last three years, resulting in a strong average age of plant of approximately 13.2 years; similarly, LVHN's average spending has averaged 139% of annual depreciation over the last three years, resulting in a strong average age of plant of around 10.8 years as of fiscal 2024. With manageable capital spending plans over the next several years of around 120% of annual deprecation (or approximately $620 million per year on average), with consistent incremental improvement to operating income levels, TJU's combined liquidity and leverage metrics should see gradual overall improvement.

Fitch expects that TJU will continue to perform well in the philanthropic market, with TJU in the early stages of developing a new philanthropic campaign with the expectation that it will build on the successful last campaign that raised over $1.1 billion.

Financial Profile - 'a'

TJU's combined unrestricted liquidity at fiscal 2024 was $5.2 billion, equal to 136.2 days cash on hand and 93.9% current long term adjusted debt. Total debt includes $4.9 billion of current and long-term debt, and another $0.63 billion of current and long-term lease expense for a total of $5.562 billion prior to this debt issuance. With $508 million of new money included into this debt issuance, unrestricted liquidity to total pro-forma total debt is equal to 86.2%. Should donor restricted endowment funds be included in this amount, for a more complete picture of TJU's liquidity with additional funds, this ratio would increase to 98.4% with donor restricted endowment funds of approximately $750 million.

TJU's current capital-related ratios are somewhat thin for an 'A' rated health system; however, key leverage and liquidity metrics should improve over time as operations improve, and it should be noted that TJU is being compared to other health systems without a commensurate large

University component or health plan entity embedded into the organization. In Fitch's forward-looking scenario analysis, key leverage metrics all improve, and even under a stress case (which includes a modest investment portfolio downturn followed by a rebound), net adjusted debt to adjusted EBITDA returns to a favorably negative position by year three, and cash-to-adjusted debt approximates 120% by year four.

Fitch expects TJU's financial and leverage profile to remain adequate as it continues to recover from operational stresses and generates additional unrestricted liquidity to support planned capital spending. Key balance sheet and leverage metrics could improve further if actual capital spending is lower than expected or if operational improvements increase faster than anticipated.

Asymmetric Additional Risk Considerations

No additional asymmetric risk considerations were factored into this rating.

TJU has approximately $5.2 billion in combined unrestricted liquidity, equal to 136.2 days cash on hand.

TJU's pro forma long debt will be approximately 85% fixed rate, with maximum annual debt service of around $282.2 million.

Similarly, TJU's combined asset allocation is approximately 29% cash and fixed income instruments, 55% domestic and international equities, and 16% alternatives and other, and does not pose an asymmetric risk.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

--Sustained operating EBITDA margin compression that would be expected to remain less than 7%; could lead to a weaker operating risk assessment;

--Notably weaker capital-related ratios, particularly if cash-to-adjusted debt was expected to remain below 90%.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/ Upgrade

--Sustained longer term revision to operating EBITDA margins in the 8% range or higher, should trigger a re-evaluation of TJU's operating risk overall assessment to Fitch's 'strong' assessment, and indicate plausible positive rating activity;

--Material liquidity growth leading to considerably stronger unrestricted liquidity to total debt in excess of 120%.

PROFILE

Thomas Jefferson University (TJU) is a not for profit academic and research institution located in Philadelphia, Pennsylvania. TJU was founded as a medical college in 1824 and has since expanded to include a wide range of health care, science, architecture, design, business, and engineering programs. The university's mission is to reimagine health, education, and discovery to create unparalleled value, focusing on improving lives and providing high-quality health care through its clinical operations, which include a major teaching hospital and a network of outpatient centers and physicians.

TJU's health care network includes multiple hospitals and a broad array of health care services, making it a significant provider of patient care in the Greater Philadelphia Region. In addition to its academic mission (with over 8,300 students) and health care delivery network, TJU also has an insurance plan, the Jefferson Health Plan (JHP) with over 350,000 members.

TJU has undergone significant growth and integration over the years, merging with several health care systems and educational institutions. Notable combinations include the integration of Abington Health in 2015, Philadelphia University in 2017, the Einstein Healthcare Network in 2021, and most recently Lehigh Valley Health Network (LVHN) this year. These mergers have allowed TJU to enhance its educational and health care offerings, creating a comprehensive university that leverages the strengths of its affiliates to deliver high-impact education and value for students and patients.

Financially, legacy TJU reported total operating revenues, gains, and other support of approximately $9.8 billion for the FYE June 30, 2024 (combined with LVHN at $14.2 billion).

Date of Relevant Committee

11 October 2024

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Jefferson Health System (PA)	LT IDR	A	New Rating		
• Jefferson Health	LT	A	New Rating		

ENTITY/DEBT	RATING			RECOVERY	PRIOR
System (PA) /General Revenues/ 1 LT					
• Lehigh Valley Health Network (PA) /General Revenues/ 1 LT	LT	A ◘	New Rating		WD

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◈	◆
STABLE	◘	

Applicable Criteria

U.S. Not-For-Profit Hospitals and Health Systems Rating Criteria (pub.18 Nov 2020) (including rating assumption sensitivity)

U.S. Public Sector, Revenue-Supported Entities Rating Criteria (pub.12 Jan 2024) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Portfolio Analysis Model (PAM), v2.0.0 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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