S&P Global
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Virginia-DC HFMA
2023 Fall Conference

How Health Care Entities Can Mitigate Credit Risks from Environmental, Social, and Governance factors

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S&P Global Ratings

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Publicly rated entities in Virginia and DC include…

CENTRA

CHESAPEAKE REGIONAL HEALTHCARE

VHC HEALTH™

Sentara® Health

VCU Health™

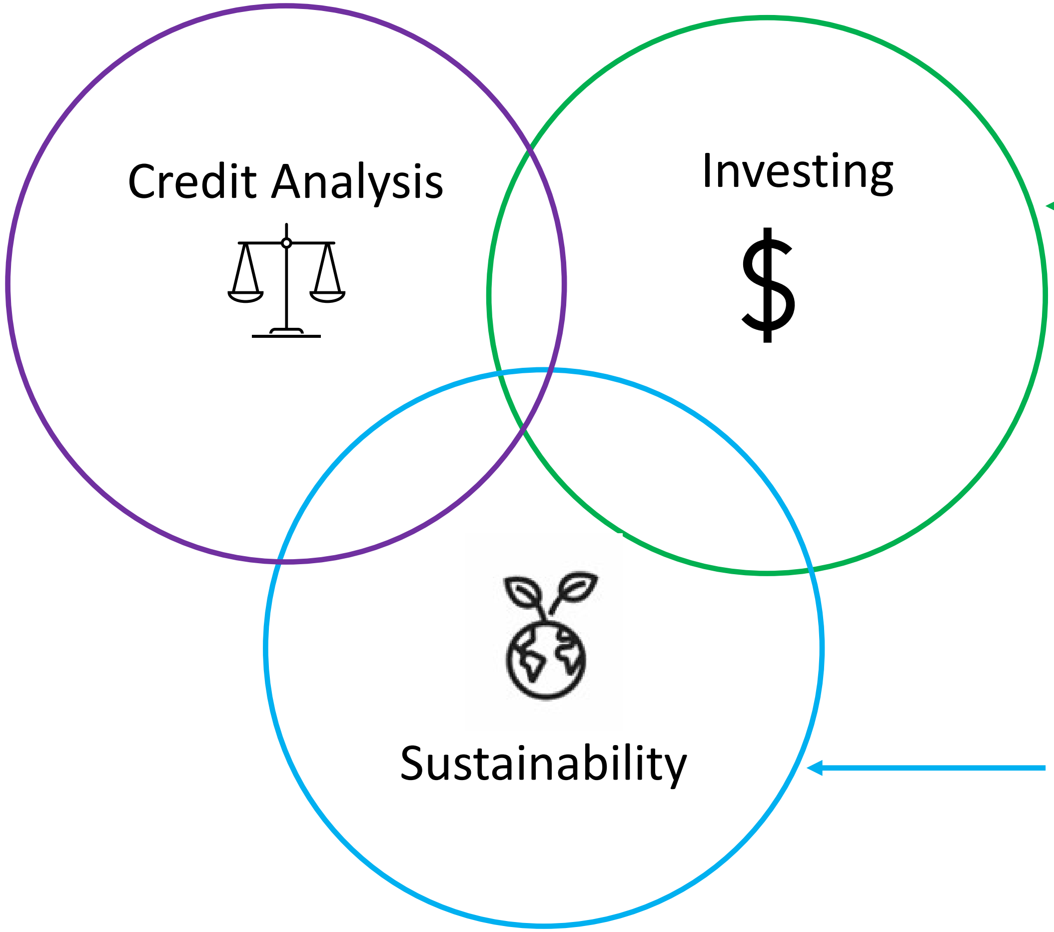
CARILION CLINIC

ValleyHealth

INOVA®

ESG in the Municipal Market | An Overview

How ESG factors affect an issuer's credit rating including disclosure requirements



- ESG investment mandates
- Dedicated exchange traded funds (ETFs) and indices
- Impact investing

Labeled bonds and general entity specific sustainability priorities

ESG Principles Criteria | General Principles of ESG Factors & Ratings

Environmental factors

- Climate transition risks
- Physical risks
- Natural capital
- Waste and pollution
- Other environmental factors

Social factors

- Health and safety
- Social capital
- Human capital
- Other social factors

Governance factors

- Governance structure
- Risk management, culture, and oversight
- Transparency and reporting
- Other governance factors

Principle One

Our long-term issuer credit ratings do not have a pre-determined time horizon.

Principle Two

The current and potential future influence of ESG credit factors on creditworthiness can differ by industry, geography, and entity.

Principle Three

The direction of and visibility into ESG credit factors may be uncertain and can change rapidly.

Principle Four

The influence of ESG credit factors may change over time, which is reflected in the dynamic nature of our credit ratings.

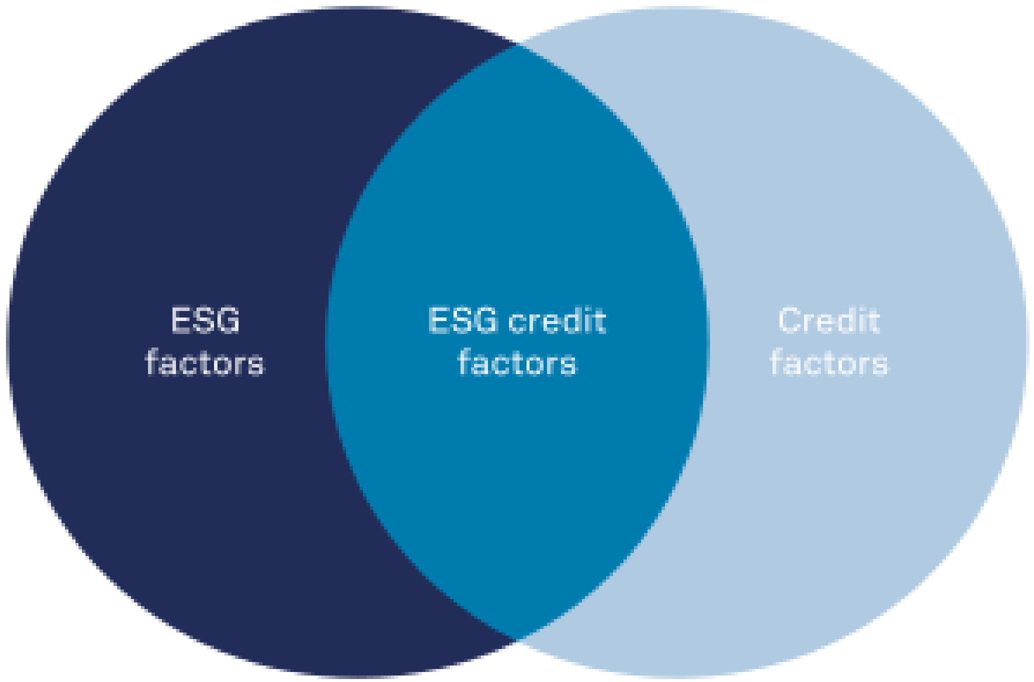
Principle Five

Strong creditworthiness does not necessarily correlate with strong ESG credentials and vice versa.

ESG--Environmental, social, and governance. Source: S&P Global Ratings.

ESG In Credit Ratings | Materiality Is Key

The materiality of ESG factors varies by sector and region and may or may not be relevant in our rating analysis.



ESG--Environmental, Social, and Governance. Source: S&P Global Ratings.

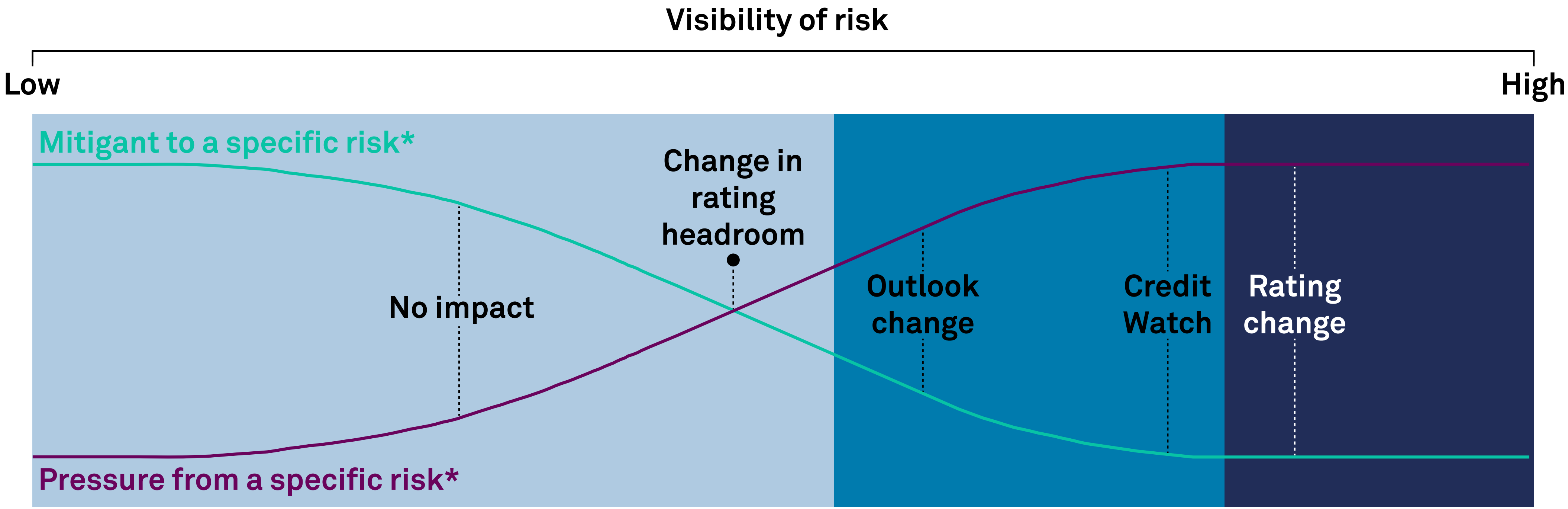
Source: Environmental, Social, And Governance Principles In Credit Ratings, published Oct. 10, 2021

- ESG factors incorporate an entity's impact from, and effect on the natural and social environment and the quality of its governance.
- **Not all ESG factors materially influence creditworthiness**.
- **ESG credit factors** are those ESG factors that can **materially influence the creditworthiness** of a rated entity and for which we have **sufficient visibility and certainty** to include in our rating analysis.

General Principles | ESG Credit Factors Can Influence Credit Ratings

– Principle Four: Our credit ratings are dynamic

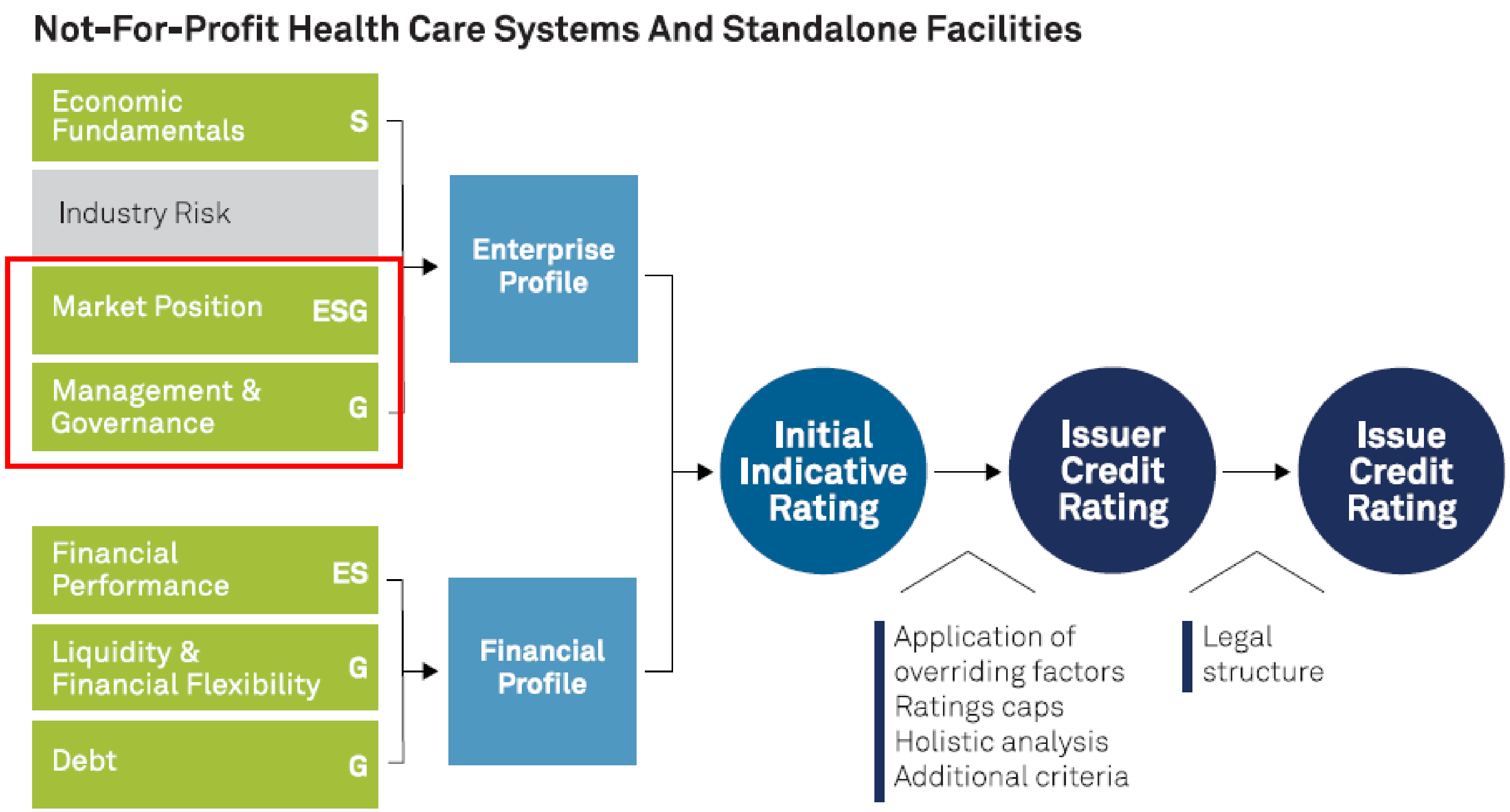
Visibility of Risks: Impact on Ratings



**Both the pressure from the risk and the mitigants to the risk can change or stay the same over time. This chart shows how the influence of a specific ESG risk – or opportunity – may change over time as visibility increases.*

Source: S&P Global Ratings.

Sector Specific Criteria | ESG Credit Risks Embedded In Analysis



Credit risks identified in the Enterprise Profile can affect the Financial Profile. But good governance and risk management practices underscore important mitigants for credit rating stability.

Source: Through the ESG Lens 3.0: The Intersection of ESG Credit Factors and U.S. Public Finance Credit Factors, published March 2, 2022

Environmental | Materiality: Acute – For Now

Climate transition risks
- Costs or benefits from transitioning to net-zero away from carbon-based energy supply
- Policy or regulatory changes related to managing carbon and curtail greenhouse gas emissions

Physical risks
- Acute (i.e., increased severity of extreme weather events such as hurricanes, flooding, wildfires, and drought and their impact on water supply, economic or service areas, and facilities and/or infrastructure)
- Chronic (i.e., longer-term shifts in climate patterns including precipitation and temperature that may result in chronic heat and cold waves and their impact on water supply, economic or service areas, and facilities and/or infrastructure, as well as sea level rise)
- Natural disasters (e.g., earthquakes, tornados)

Natural capital
- Water scarcity or supply limitations that affect operations or an entity's economic base or service area
- Biodiversity and land use related to development patterns in protected or preserved areas

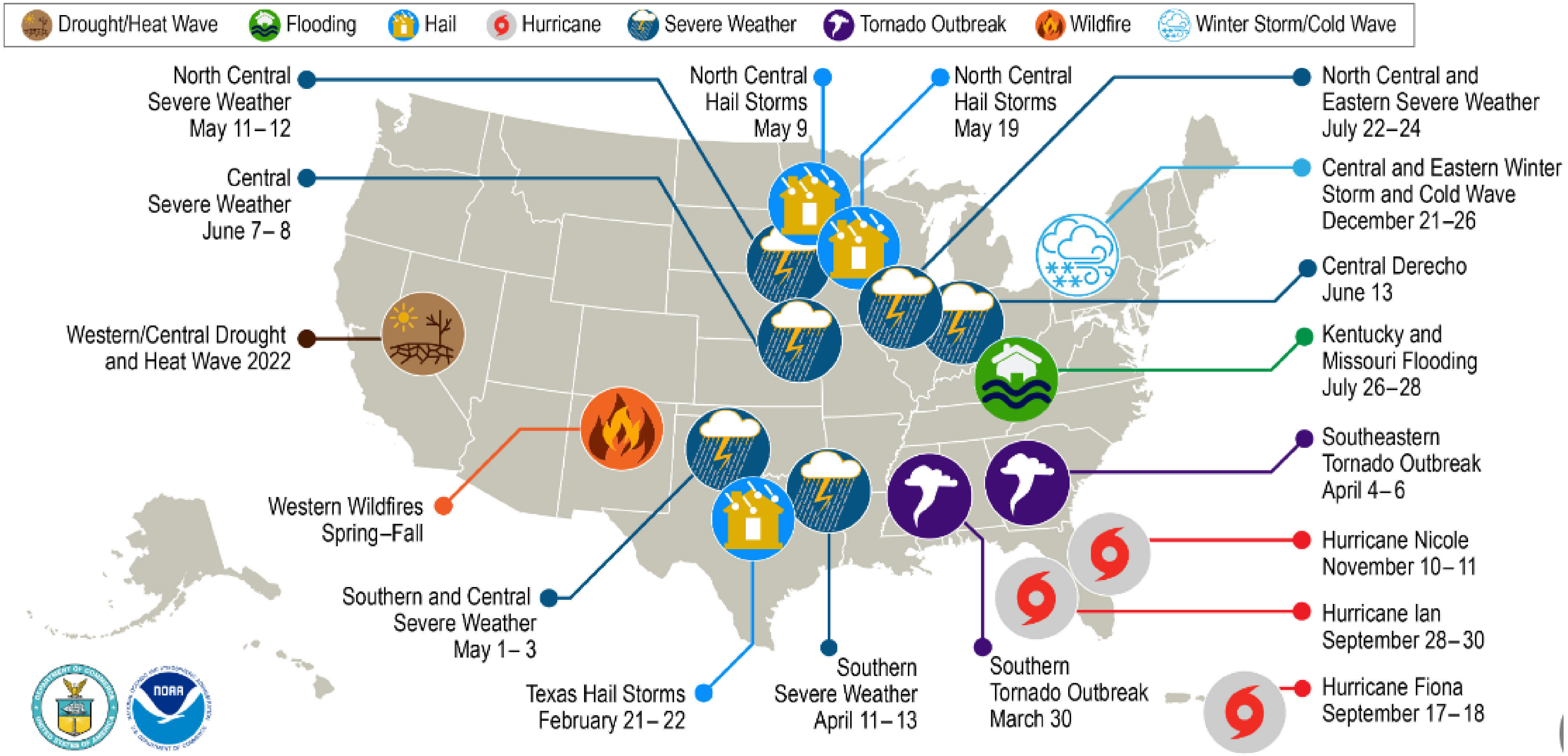
Waste and pollution
- Environmental considerations relative to sewer overflows; consent decrees stemming from pollution issues
- Impact of environmental regulations related to water or wastewater

Risk	Potential Credit Impact
Extreme weather (ex. Hurricanes, heat days)	Facility damage; unplanned operating costs; demand changes from population displacement
Energy transition	Power utilities typically wrestle with storage and reliability when increasing reliance on renewable power
GHG emissions	Buildings contribute about 13% to annual GHG emissions
Water scarcity	Population and economic development pressures

Read more: Through the ESG Lens 3.0: The Intersection of ESG Credit Factors and U.S. Public Finance Credit Factors, published March 2, 2022

U.S. Faces Increasing Number of Large-Scale Climate Disasters

U.S. 2022 Billion Dollar Weather And Climate Disasters – 18 Totaling $165 billion in losses



Source: National Oceanic and Atmospheric Administration (NOAA).

Social | Materiality: Short and Long-term

Health and safety
- Demand, revenue, or expense driven changes related to health and safety events that alter social behaviors
- Emerging contaminants in water supply as well as lead and copper pipes that could affect residents in the enterprise's service area

Social capital
- Demographic and population trends that affect a government's services or demand for a not-for-profit enterprise's product or infrastructure
- Income levels, income inequality, disparity in access to services by vulnerable groups
- Affordability of services provided by an enterprise
- Political unrest stemming from community or social issues

Human capital
- Operational pressures related to renumeration, recruitment or retention of an entity's workforce
- Exposure to labor unrest or challenges and costs related to union negotiations and settlements
- Diversity and succession planning when it broadly affects a government or not-for-profit enterprise

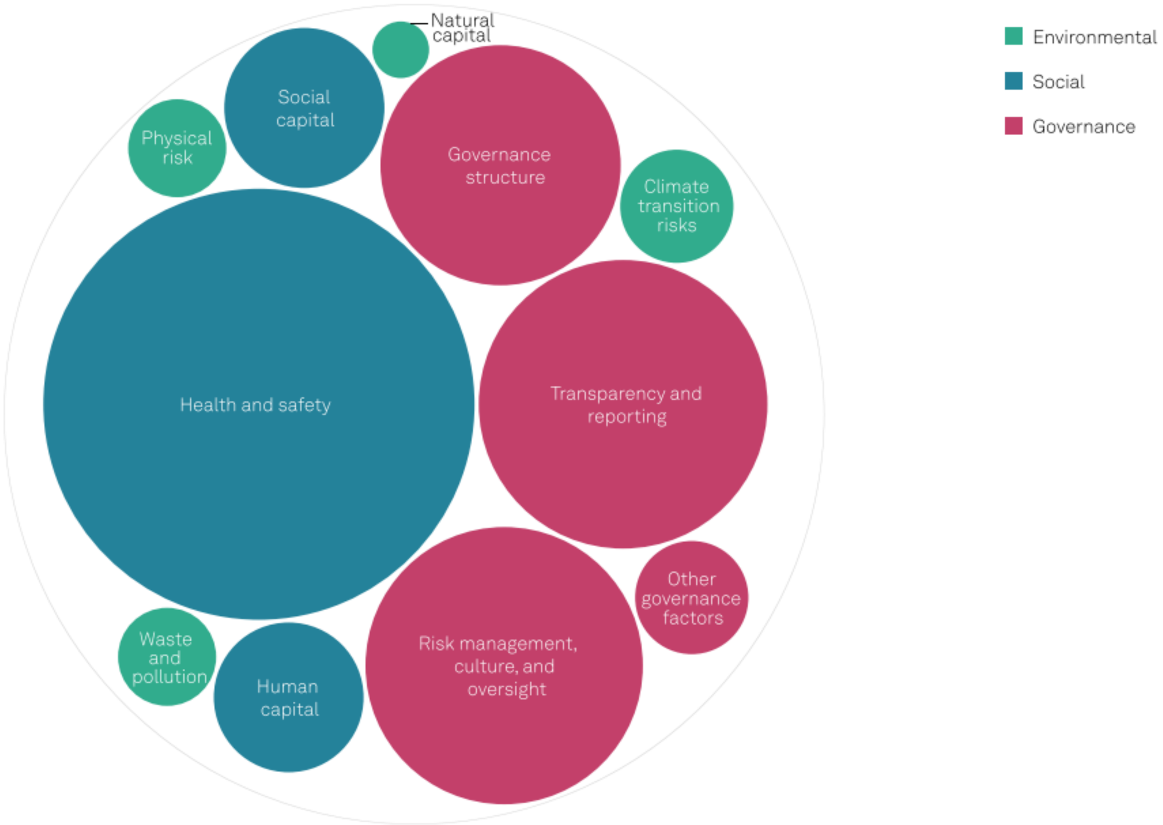
Risk	Potential Credit Impact
Pandemic	Pause on elective surgeries; overwhelming demand during surges
Demographics of service area	Changes in demand for certain services; clinician recruitment and retention challenges; payer mix; U.S. aging generally
Affordability	Reimbursement pressure to hospitals; increased bad debt expense
Labor	Retirements and burn out; agency labor; union settlements

Read more: Through the ESG Lens 3.0: The Intersection of ESG Credit Factors and U.S. Public Finance Credit Factors, published March 2, 2022

Social Credit Factors Create Financial Materiality for Health Care Entities in 2021, 2022, and 2023 (YTD)

Leading ESG factors driving credit rating actions as a proportion of total tagged factors

Year to date



Data as of May 31, 2023. Bubble size is determined by the occurrence of factors between January and May 2023. In instances where multiple ESG factors were recorded as the main drivers of the credit rating action, each is counted for the purposes of this infographic. ESG--Environmental, social, and governance. Source: S&P Global Ratings.

Human Capital credit risks were material for rating actions:

- 2023 (YTD): 4; 3 downgrades
- 2022: 8; 6 downgrades
- 2021: One downgrade

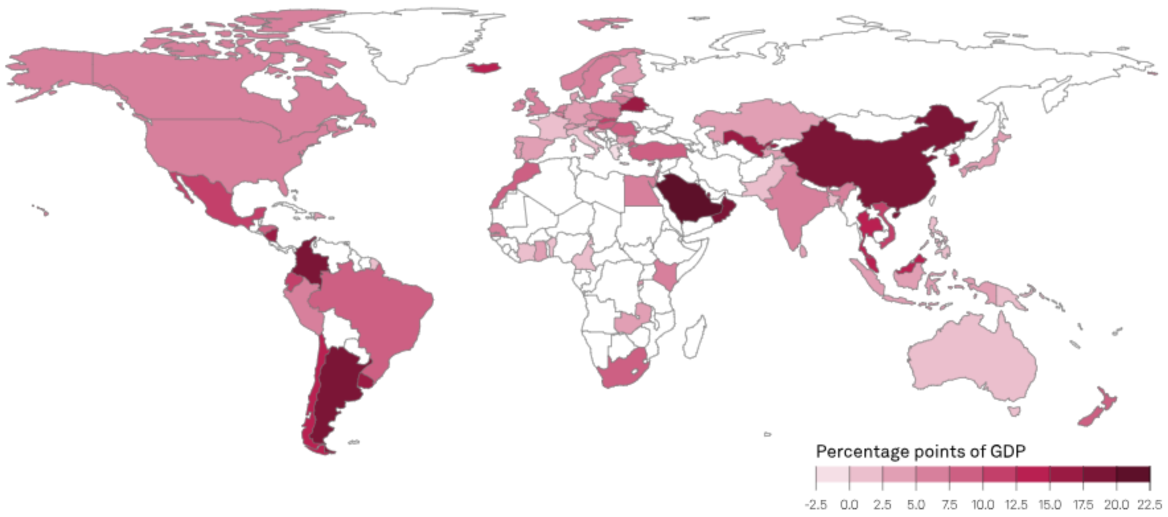
Health and Safety credit risks were material for ratings actions stemming from the pandemic:

- 2020: 8; 3 downgrades

Read more: ESG in Credit Ratings Newsletter – June edition, published June 16, 2023

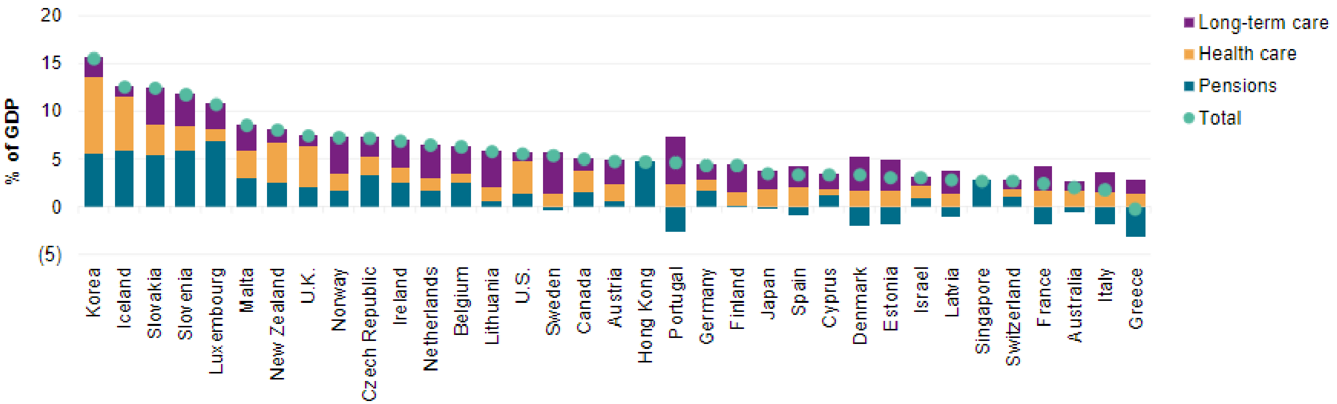
Global Aging Trends Likely to Lead to Higher Costs for Health Care Entities

Our simulation suggests large variations across countries in age-related expenditure pressures
Simulated change in age-related spending in "no policy change" scenario, 2022-2060



Source: S&P Global Ratings.

Health and long-term care will drive most rich countries' spending pressures, while some countries could enjoy offsetting improvements in pension spending
Simulated change in annual age-related expenditure 2022-2060, by spending category



Source: S&P Global Ratings.

Without policy changes to control health care spending, global aging expenditures in the U.S. will rise by an amount potentially equal to 5% of GDP by 2060.

Read more: Global Aging 2023: The Clock Ticks, published Jan. 18, 2023

Governance | Materiality: Important Mitigant or Risk

Governance structure
- Elected or appointed board relationship with management
- Federal/state regulatory framework
- Key person succession planning
- State government support (or lack of support) for distressed entities, typically considered as part of the Institutional Framework score for municipalities and counties

Risk management, culture, and oversight
- Vulnerable financial management assessments when it stems from pervasive budgetary imbalances or missed debt service payments
- Cyber security protocols or lack of preparation when results in operational or financial impacts
- Pension/OPEB plan governance related to legal flexibility to modify benefits, adherence to a control framework that controls the liability funding schedule
- Headline risk: self-inflicted corruption and mis-dealings, adverse publicity that results in reputation risk or operational pressure

Transparency and reporting
- Adherence to reporting standards as identified in policies and practices
- Transparency of information provided to stakeholders related to key decision making
- Lack of statutory requirements for certain types of accounting standards that results in credit weakness or transparency concerns

Risk	Potential Credit Impact
M&A activity	Financial and debt impacts; service diversification and expansion; integration risks
Persistent budgetary imbalances	Management preparation and board support to pivot & respond to risks
Cybersecurity	Prepare, respond, recover from attacks or intrusions
Covenant violations	Advance discussions for waivers; financial forecasting and planning to anticipate cash flow weaknesses
Key position turnover	Succession planning; stabilization of operations and priorities

Read more: Through the ESG Lens 3.0: The Intersection of ESG Credit Factors and U.S. Public Finance Credit Factors, published March 2, 2022

How Management Teams Can Mitigate Risks

Environmental

Adaptative Building Materials

Emergency Planning

Electricity Redundancy; Procurement Modifications & Facility Optimization

Social

Regular review of services to match demographics

Innovative techniques toward staffing and recruitment; relationships with labor groups

General health and safety events and how these surges can affect regular operations

Governance

Reserves & Liquidity

Financial & Capital Planning

Prioritization & Execution

Longer-term strategies likely to involve data/technology for care delivery redesign & efficiencies, clinical developments, M&A and affiliations, and/or broader diversification.

Examples | Identification of financially material credit risks

Old Dominion Health

Credit Overview

The rating reflects ODH's healthy enterprise profile, which has improved through growth and acquisitions, as well as the organization's healthy and very stable financial profile notwithstanding industry challenges.

The organization's strong and consistent financial performance is augmented by expansion through modest growth in the system's existing facilities, combined with steady, modest acquisition activity. We expect ODH will continue to add facilities in a manner that is generally consistent with its financial profile, although we are not aware of any pending acquisitions. We expect financial performance will remain lower over the outlook period relative to pre-pandemic levels given inflationary pressures, elevated labor costs, and the implementation of Medicare sequestration. Management has discussed the possibility of expanding its geographic footprint into other states.

Environmental, social, and governance

We view social factors as neutral in our credit rating analysis. However, the COVID-19 pandemic has resulted in more human capital risks, particularly for health care organizations, including increased temporary staffing and supplies costs. These pressures have materialized for the sector in thin operating margins as well as lower debt service coverage. Overall environmental and governance factors are neutral in our credit rating analysis and we note that ODH’s management team has a strong track record of execution and meeting budget.

CommonwealthCare

Credit Overview

The 'AA+' rating reflects our opinion of CommonwealthCare's excellent enterprise profile, which is characterized by its leading business position as an integrated delivery system with a comprehensive network of hospitals, outpatient services and facilities, primary and specialty care physician practices, and health and wellness initiatives serving the economically robust northern Virginia-Washington, D.C. metropolitan area, and contiguous counties in Virginia and Maryland. The rating also reflects our view of CC's extremely strong financial profile, which has continued to generate positive margins despite heightened labor and inflationary pressures in the healthcare sector. While operating and EBIDA margins declined substantially in fiscal year 2022 compared with historical trends, CC weathered pressures in the sector better than others in the industry and maintained positive margins. Despite the likelihood that labor challenges and inflationary pressures will continue over the near term, CC's interim data for the first three months of fiscal 2023, ended March 31, already show some margin recovery, with continued improvement expected throughout the year. Moreover, CC's use of contract labor, one of the main drivers of expense increases in 2022, is on a downward trend, as are the hourly rates that CC pays for agency staff. After two years of lower capital spending in fiscal years 2020 and 2021 to preserve liquidity while responding to the Covid-19 pandemic, capital expenses returned to pre-pandemic levels in 2022. While its excellent liquidity and strong operations provide CC a healthy cushion, we see the potential of balance sheet dilution if such a sizable capital project is not executed effectively.

Environmental, social, and governance

We analyzed CommonwealthCare's environmental, governance, and social risk, and view all as neutral to our credit rating analysis. CC benefits from its location in an area with a growing population and stable employment base, which results in a favorable payer mix with a strong commercial component. While CC faces some human capital risk due to heightened labor and salary pressures, this is mitigated by both its demographic fundamentals and system integration. Furthermore, CC is experiencing vacancy and turnover rates that, although historically elevated, are lower than those of the industry average.

Beltway Health System

Credit Overview

The rating reflects our view of the system's business position, leading market share, and stable operations, notwithstanding industry pressures, including high labor and inflationary costs. The team has continued to focus on the performance improvement plan that has included cost savings and revenue cycle improvements. The new management team has remained focused on execution and divesting of noncore assets that included sales of its skilled nursing and assisted and independent living divisions, which will have a net positive impact on profitability. Over the past few years, Beltway Health System's management team has had a track record of improved budgeting and has been on track meeting financial budgets.

BHS' management team continues to focus on strategic growth, and entered into a clinical affiliation with the University of Virginia in 2021 that has enabled the system to treat more patients locally and provide tertiary care.

The rating also reflects a negative holistic adjustment, indicating limited diversity as well as a limited track record of current operating performance trends. A higher rating or positive outlook would be predicated on a sustained track record of improved operations, given the continued industry pressures as well as the continued stability of the management team.

Environmental, social, and governance

We view social factors as neutral in our credit rating analysis, but note that Beltway Health System has high exposure to governmental payers, notably Medicaid, which represents 17% of the gross payer mix and has increased over the past few years, presenting increased social capital risk. COVID-19 exposes BHS and the entire sector to additional health and safety social risks that, while improving, remain a threat and point of uncertainty, particularly with human capital risks, notably increased staffing challenges and use of agency labor, as well as higher labor costs. We also consider governance and environmental risks to be neutral to our credit rating analysis.

Questions?

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