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RATING ACTION COMMENTARY

Fitch Upgrades Loma Linda University Medical Center's (CA) IDR to 'BB+'; Outlook Stable

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Fitch Ratings - Chicago - 14 Nov 2022: Fitch Ratings has upgraded Loma Linda University Medical Center's (LLUMC) Issuer Default Rating (IDR) to 'BB+' from 'BB'. Fitch has also upgraded to 'BB+' from 'BB' the ratings on revenue bonds issued by the California Statewide Communities Development Authority on behalf of LLUMC.

The Rating Outlook is Stable.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
Loma Linda University Medical Center (CA)	LT IDR Upgrade	BB+ Rating Outlook Stable	BB Rating Outlook Stable

Loma Linda University Medical Center (CA) /General Revenues/1 LT	LT	BB+ Rating Outlook Stable	Upgrade	BB Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

SECURITY

The bonds are secured by a gross receivables pledge and a mortgage pledge of the obligated group (OG). There are also debt service reserve funds (DSRF) in place. The OG includes LLUMC, LLU Children's Hospital, the LLUMC - Murrieta hospital, and Loma Linda University Behavioral Medicine Center. The OG accounts for almost all of the consolidated system assets and revenues. Fitch's analysis is based on the consolidated system.

ANALYTICAL CONCLUSION

The upgrade to 'BB+' incorporates LLUMC's major new hospital, which is now open, and the system has been operating in their new environment for more than one year, removing a considerable risk factor. As the only academic medical center (AMC) and only children's hospital serving a large population base in the Inland Empire, LLUMC is well positioned from a competitive perspective.

Assuming a reasonable pace of operating performance, the system's capital-related metrics should show improvement over time, even under a stress case in Fitch's forward-looking scenario analysis, especially given that capital spending plans are somewhat limited and much of that capex is expected to be funded by external sources (e.g., State of California Prop 4 funding for children's hospitals).

KEY RATING DRIVERS

Revenue Defensibility: 'bbb'

High Acuity Academic Provider in Challenging Market

LLUMC's midrange revenue defensibility is characterized by its broad reach for tertiary and quaternary services as the only AMC and children's hospital covering a broad geography and population base in the Inland Empire service area, which includes the population centers of San Bernardino County and northern Riverside County. While competing hospitals are present and inpatient market share is dispersed among a number of providers, LLUMC is the exclusive or decidedly leading provider of many high-end services.

While Medi-Cal (Medicaid) and self-pay represent a very high 40% or more of LLUMC's gross revenue (including 41.5% in fiscal 2022), this is common for AMCs, particularly those that are designated trauma centers and those that include large children's hospitals (LLUMC's children's hospital represents nearly one-quarter of system total operating revenue).

Demographic indicators of the service area are generally considered to be stable. Both San Bernardino and Riverside counties are experiencing population growth slightly above the U.S. average. The unemployment rate in the Riverside-San Bernardino-Ontario MSA is just above the national average (per U.S. Bureau of Labor Statistics data).

LLUMC's revenue defensibility is bolstered by its strong relationship with Loma Linda University (LLU, IDR: A+). LLUMC's and LLU's campuses are adjacent. The university operates eight schools, seven of which are focused on healthcare education and research, including schools of medicine, nursing, and public health. While LLU and LLUMC are separate legal organizations and not obligated on each other's debt, they are tightly aligned and the medical system is integral to the university's teaching and research.

Operating Risk: 'a'

Variable but Generally Good Operating Margins; Macro Pressures Present

Historically, while variable, LLUMC's operating EBITDA margins are generally strong. Between fiscals 2017 and 2022, LLUMC's operating EBITDA margin averaged approximately 10% (ranging from a low of 6.5% in fiscal 2022 to a high of nearly 16% in fiscal 2018).

As the region's AMC and only children's hospital, demand for LLUMC is considerable and growing with the opening of the new Dennis and Carol Troesh medical campus in August 2021. Since opening the new hospital, many key volumes have increased noticeably, even though the first full fiscal year of the hospital will not be until fiscal 2023. Key areas of volume gain in fiscal 2022 over fiscal 2021 include inpatient admissions (up 3.4%, and up 8.7% including observation stays), unique patients (up nearly 17%), outpatient surgeries (up 8.0%), and outpatient visits (up 9.1%).

While these volume gains in fiscal 2022 were particularly notable given the surge in omicron variant COVID patients in late calendar 2021 and early calendar 2022, the ongoing nurse labor disruptions that have affected the entire sector have resulted in LLUMC facing fiscal challenges. Even with considerable demand, LLUMC's operating margins were compressed in fiscal 2022 with a -2.4% operating margin and 6.5% operating EBITDA margin. Like nearly the entire US hospital sector, LLUMC had to face material labor pressures, general inflation, and the omicron surge. LLUMC had to contend with these challenges while simultaneously bearing the burden of ramping up operations at the new hospital.

Looking forward, Fitch expects that despite ongoing macro pressures, LLUMC should generally generate good operating EBITDA margins, even if metrics do not quite match the strong results recorded prior to the pandemic. Operating margins likely will be variable as the state's Hospital Quality Assurance Fee Program is not distributed evenly (although on the whole this program provides considerable cash flow to LLUMC).

With the opening of the new hospital in late summer 2021, capital spending plans are limited at LLUMC. And much of the capex that is planned is expected to receive significant external support. For example, the planned LLUMC children's outpatient center is slated to receive as much as $135 million in voter approved state proposition 4 funding. LLUMC (and LLU) has a history of successful fundraising.

Financial Profile: 'bb'

Financial Profile Improving but Remains Modest

LLUMC's financial profile is improving but still modest and consistent with a below investment grade rating. Nevertheless, key capital-related metrics should improve over time.

At audited FYE 2022 (June 30 year-end), LLUMC's unrestricted cash and investments exceeded $805 million (Medicare advances moved from unrestricted cash to restricted) and total debt was more than $2.2 billion. This translated to cash-to-debt of 43% at FYE 2022 (including DSRFs in the numerator).

LLUMC participates in the North American Division of Seventh-day Adventist multiemployer frozen defined benefit (DB) pension plan. The frozen DB plan was 100% funded as of the most recent measurement date (Jan. 1, 2021), so cash-to-adjusted debt is the same as cash-to-debt at 43% (Fitch only includes the portion of a DB pension plan that is below 80% funded when calculating adjusted debt).

LLUMC's capital-related ratios should improve over time, even in a stress case of Fitch's forward-looking scenario analysis. In the stress case the net adjusted debt-to-adjusted

EBITDA ratio remains unfavorably positive, although approaches a more palatable 3x by year five. Cash-to-adjusted debt does not fall below 35% and reaches 50% by year four. Net adjusted debt-to-adjusted EBITDA consistently below 3x and cash-to-adjusted debt sustained above 50% would indicate a financial profile more consistent with an investment grade rating.

Asymmetric Additional Risk Considerations

No asymmetric additional risk considerations were applied in this rating determination.

Financial covenants in LLUMC's MTI include a minimum debt service coverage ratio of 1.1x and minimum cash on hand of 60 days. LLUMC met the financial covenants based on fiscal 2022 results (although debt service coverage would have been below 1.0x without QAF funding).

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Liquidity deterioration beyond Fitch's stress scenario leading to weaker cash-to-adjusted debt that is expected to remain below 40%;

--Sustained thinner operating EBITDA margins that would be more consistent with a midrange operating risk profile assessment.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Improved cash-to-adjusted debt above 50%, particularly if the operating EBITDA margin is sustained in the 8% - 9% range.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-

specific best- and worst-case scenario credit ratings, visit
https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

LLUMC is part of Loma Linda University Health (LLUH), which also includes LLU, the Faculty Medical Group (LLUFMG), and several other related organizations. A board restructuring in April 2015 resulted in one unified board for the organization and the decision to coordinate fiscal year ends for all LLUH members.

LLUMC, located approximately 60 miles east of Los Angeles in Loma Linda, CA. The system operates 1,046 beds, including 364 Children's Hospital beds. LLUMC offers tertiary and quaternary series and has the only level I trauma center and level IV neonatal intensive care unit in the Inland Empire service area.

LLU is a private university affiliated with the Seventh-Day Adventist Church. It is the flagship health sciences university for the Church and its extensive network of health systems.

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

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

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This 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. For more information on Fitch's ESG Relevance Scores, visit
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APPLICABLE CRITERIA

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

Public Sector, Revenue-Supported Entities Rating Criteria – Effective from September 1, 2021 to April 27, 2023 (pub. 01 Sep 2021) (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

Dodd-Frank Rating Information Disclosure Form

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