FitchRatings

Fitch Upgrades Halifax Health, FL Revs to 'A-'; Outlook Stable

Fitch Ratings-New York-05 October 2017: Fitch Ratings has upgraded and removed the Rating Watch Evolving from the following Halifax Hospital Medical Center, FL bonds, issued on behalf of Halifax Health (Halifax):

--$158 million series 2016 to 'A-' from 'BBB+';
--$115 million series 2015 to 'A-' from 'BBB+';
--$70 million series 2008 to 'A-' from 'BBB+'.

In addition, Fitch has assigned an Issuer Default Rating (IDR) of 'A-'.

The rating on the series 2008 bonds is an underlying rating; the bonds are supported by a direct-pay letter of credit (LOC) with JPMorgan Chase Bank.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by an obligated group pledge of gross revenues, property, and all other collateral held by or pledged to the master trustee excluding ad valorem tax revenue.

KEY RATING DRIVERS

TAX REVENUE PROVIDES FLEXIBILITY: The 'A-' IDR and rating on the bonds primarily reflects Halifax's taxing capacity, which provides a significant amount of cushion against unexpected operating volatility, especially as Halifax seeks to expand its clinical footprint in Deltona, its secondary service area. Based upon the maximum 4 mill limit and fiscal 2017 property valuations, room in the taxing margin would allow for an approximate 376% increase in tax revenues, or a 8.4% increase in total fiscal 2016 operating revenues. Increases in the levy are not subject to voter referendum, which Fitch views positively.

UPCOMING CAPITAL PROJECT: Halifax is moving forward on the construction of a 42-bed inpatient facility in the city of Deltona, FL, which includes sufficient space to expand operating room and inpatient capacity to 96 beds. The project is expected to be completed by 2019, and Fitch expects the project to be financed with $105 million in private-debt proceeds (issued outside the obligated group). Fitch's financial analysis is based on the consolidated entity, so the upgrade incorporates the impact of the additional debt.

INCREASED DEBT BURDEN: A pro forma analysis of the $105 million borrowing shows total system debt increasing by 28% and pro forma maximum annual debt service (MADS) equaling a high 4.7% of total fiscal 2016 revenues, which compares unfavorably to Fitch's 'A' category medians of 2.7%. However, metrics are expected to improve following completion of the Deltona facility and inclusion of the additional revenues of the facility.

SOLID OPERATIONAL PERFORMANCE: While experiencing slight profitability compression, Halifax maintained a good operational performance through the 10-month interim period (ending July 31, 2017) as evidenced by its 0.8% operating margin, 8.3% operating EBITDA margin, and 9.4% EBITDA margin, which are sufficient to support its 'A-' rating given the revenue flexibility provided by Halifax's taxing capacity.

LEADING MARKET SHARE: Halifax is the safety net provider of the county and maintains a leading 60% inpatient market share (2016 data) in its primary service area. Its position as the safety net provider exposes Halifax to an elevated level of Medicaid and self-pay revenue, which equaled 19.5% of gross fiscal 2016 revenues.

RATING SENSITIVITIES

CAPITAL PROJECT EXECUTION: Halifax Health has yet to finalize the financing for its new inpatient facility in Deltona. There could be negative pressure on the rating if the final terms of the financing differ from Fitch's expectations or if the Deltona project is not completed on time and on budget.

CREDIT PROFILE

Halifax Hospital Medical Center (d/b/a Halifax Health) is a health system serving northeastern Volusia County, FL. Halifax Health operates a 568-bed referral hospital in Daytona Beach, an 80-bed community hospital in Port Orange, and a 30-bed behavioral health center two miles north of its main campus in Daytona Beach. Halifax Health was established as an independent special taxing district of the State of Florida that was established in 1925 and began operations in 1928. Total revenues in fiscal 2016 (year-ended Sept. 30) were $530.7 million.

The obligated group includes Halifax Hospital Medical Center (HHMC) and H.H. Holdings. Halifax Hospital Medical Center was originally created in 1925 under the name Halifax Hospital District, and now operates as Halifax Health. HHMC is the sole corporate member of H.H. Holdings, which was established to manage the remaining assets resulting from the sale of the Florida Health Care Plan in 2008. The obligated group represented approximately 97.5% of total assets and 90.2% of total revenues in fiscal 2016. Fitch's analysis is based on the consolidated entity.

TAX REVENUES PROVIDES FLEXIBILITY

Halifax Health is an independent special taxing district of the state of Florida that was established in 1925 and began operations in 1928. It has the authority to levy up to 4 mills based on the assessed valuation of taxable real and personal property, which is not subject to voter referendum. The 'A-' rating reflects Halifax's taxing capacity, which provides a significant amount of cushion against unexpected operating volatility and is viewed favorably by Fitch. Overall, based upon the maximum 4 mill limit and fiscal 2017 property valuations, room in the taxing margin would allow for an approximate 376% increase in tax revenues, or a 8.4% increase in total fiscal 2016 operating revenues. However, by design, the district is reducing its reliance on tax revenues. The rate was 0.7561 mills (approximately $11 million in gross tax revenues) and is budgeted to be 0.3781 mills for fiscal 2018. Fitch includes the levy in other operating revenue and the associated expenses in operating expenses, which is consistent with financial statement reporting.

UPCOMING CAPITAL PROJECT

Halifax is about to begin implementing its strategic plan of expanding its presence in the Deltona market. Halifax had received a certificate of need for inpatient beds in Deltona back in June 2016. Additionally, Halifax has already built and begun operations of a free-standing emergency room in Deltona in April 2017, which has shown promising results to date. In December 2017, Halifax plans on beginning construction of a new 42-bed inpatient facility which is expected to open in late 2019. Total project costs are expected to be $105 million, which are expected to be financed with new private-debt proceeds. Additionally, Halifax plans to lease land to a third-party developer for the construction of a medical office building and an ambulatory surgery center.

The new debt proceeds are expected to be privately-placed and issued by Halifax Management System (HMS), which is outside of the current obligated group. HMS currently owns the Port Orange hospital building and two medical office buildings, and has only $1.8 million in debt currently outstanding. Fitch's analysis is based on consolidated financial statements and this additional debt is included in our analysis. Despite the additional debt burden, the Deltona facility is expected to be accretive to Halifax's overall financial profile. Current management projections estimate the new facilities producing positive operating results by fiscal 2021, with approximately $56 million in additional net patient service revenue online by fiscal 2022.

SUFFICIENT FINANCIAL/OPERATING PROFILES

Despite minor compression in profitability, Halifax continued its solid operational performance through the 10-month interim period as evidenced by its 0.8% operating margin, 8.3% operating EBITDA margin, and 9.4% EBITDA margin which remains slightly below Fitch's 'A' category medians of 3.0%, 9.4%, and 11.3%, respectively. However, historically, Halifax has maintained operational performance at or above 'A' category medians as evidenced by the 3.9% operating margin, 12.4% operating EBITDA margin, and 12.8% EBITDA margin averaged between fiscal 2014 and 2016. Fitch expects profitability to remains somewhat suppressed in the coming years as the new Deltona facility is expected to take a couple years to achieve positive operating results. However, by 2022, the new facility is anticipated to produce approximately $17 million in net cash flow and $56 million in additional net patient service revenue.

At the 10-month interim period, Halifax had approximately $355 million in unrestricted cash and investments which translates into a solid 250 DCOH, 97% cash to debt (including approximately $20 million in unamortized bond premium), and 17x cushion ratio which shows mixed results when compared to Fitch's 'A' category medians of 218, 150.6%, and 19.8x. The additional debt associated with their upcoming capital project is expected to increase Halifax's total debt position and MADS. Based upon the ten-month interim statements, pro forma cash to debt is expected to fall to 75%, while pro forma cushion ratio is expected to be reduced to 14.2x which both remain sufficient to support a 'A-' rating given the financial flexibility afforded by Halifax's tax revenue support. Overall, the project is expected to be accretive to Halifax's financial position and its liquidity position is expected to increase in the coming years. Current management projections illustrate cash to debt approaching 95% by 2022.

DEBT PROFILE

As the 10-month interim period, Halifax had approximately $367 million in outstanding debt (including approximately $20 million in unamortized bond premium), which is comprised of $297 million in fixed-rate debt and $70 million in variable-rate debt. The $70 million in series 2008 bonds are variable-rate demand bonds (reset weekly) which are secured by a letter of credit with JP Morgan Chase (rated AA-/F1+), which expires on Nov. 17, 2020. The entire $70 million is swapped to a synthetic fixed-rate, with Citigroup (rated A/F1) as the counterparty and no collateral posting threshold. As of Dec. 31, 2016, the mark-to-market on the swap was negative $30.7 million.

In conjunction with their upcoming capital project, Halifax is expected to issue approximately $105 million in privately-placed debt (outside of the obligated group) to help pay for the financing costs of the project. This debt would increase Halifax's total debt position by approximately 28%. Pro forma MADS is measured at $25 million, with MADS increasing incrementally to $25 million by 2020 from $20.5 million, where it remains level until maturity in 2046. Pro forma MADS is a 19% increase from current levels and represents a high 4.7% of total fiscal 2016 revenues which is weaker than Fitch's 'A' category medians of 2.7%. Pro forma coverage has averaged 2.6x over the last three fiscal years which is also weaker than the category median of 3.7x. However, Halifax's taxing margin helps offset concerns over its high debt burden and lower coverage levels.

Additionally, Halifax's new inpatient facility is expected to be accretive to its financial profile and should help improve debt coverage with an expanded revenue base. By 2022, when the new Deltona inpatient facility is expected to achieve positive operating results, Halifax's debt burden and coverage levels are expected to be more manageable and improve to 4% and 2.8x respectively, which will be more in line with its 'A-' peers. Overall, while Halifax's increased debt burden is a credit concern, concerns are currently mitigated by Halifax's strong, consistent operational performances, its ability to levy taxes to support operations, and the forecasted improvements in its revenue base following completion of the new Deltona inpatient facility.

DISCLOSURE

Halifax covenants to provide audited disclosure within 120 days and quarterly disclosure within 45 days of period end to the Municipal Security Rulemaking Board's EMMA system. Disclosure to Fitch has been timely and thorough, and includes a management discussion and analysis, as well as medical staff, utilization, and service area economic data, which Fitch notes is best practice.

CRITERIA VARIATION

The analysis supporting the 'A-' IDR on Halifax includes a variation from the U.S. Nonprofit Hospitals and Health Systems Rating Criteria. Enhanced analysis under the variation relates to the evaluation of the strength of the tax revenues available to support operations. This evaluation is supported by Fitch's U.S. Tax-Supported Rating Criteria dated May 31, 2017 that includes refinements to the analysis of both tax revenue volatility, through the new Fitch Analytical Sensitivity Tool (FAST), and the value of taxing capacity relative to the issuer's potential revenue stress in a downturn.

Contact:

Primary Analyst
Ryan J. Pami, CFA
Associate Director
+1-212-908-0803
Fitch Ratings, Inc.
33 Whitehall Street
New York, NY 10004

Secondary Analyst
Gary Sokolow
Director
+1-212-908-9186

Committee Chairperson
Eva Thein
Senior Director
+1-212-908-0674

Media Relations: Benjamin Rippey, New York, Tel: +1 646 582 4588, Email: benjamin.rippey@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria
Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017) (https://www.fitchratings.com/site/re/898969)
U.S. Nonprofit Hospitals and Health Systems Rating Criteria (pub. 09 Jun 2015) (https://www.fitchratings.com/site/re/866807)
U.S. Public Finance Tax-Supported Rating Criteria (pub. 31 May 2017) (https://www.fitchratings.com/site/re/898466)

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