Fitch Ratings

RATING ACTION COMMENTARY

Fitch Rates UPMC's (PA) Series 2022A, 2022B, 2017C and D2 Bonds 'A'; Outlook to Positive

Fri 25 Mar, 2022 - 2:17 PM ET

Fitch Ratings - New York - 25 Mar 2022: Fitch Ratings has assigned an 'A' rating to the following series of bonds expected to be issued on behalf of UPMC (PA):

--$200,000,000 Pennsylvania Economic Development Financing Authority, series 2022A;

--$180,000,000 Monroeville Finance Authority, series 2022B;

--$135,000,000 Pennsylvania Economic Development Financing Authority, series 2017C

--$400,000,000 Allegheny County Hospital Development Authority, series 2017D-2.

In addition, Fitch has affirmed UPMC's Issuer Default Rating and revenue bond ratings on UPMC's outstanding parity debt issued by UPMC through various issuing authorities.

The Rating Outlook is revised to Positive from Stable.

New Issue Details

The series 2022A and 2022B bonds are expected to be issued as fixed-rate, tax-exempt bonds. Proceeds from the 2022A bonds include approximately $100 million of new money for capital projects and, together with other funds, for the refunding of the outstanding Dauphin County General Authority Health System Revenue Bonds, Series 2012A (Pinnacle Health System Project).

Proceeds of the series 2022B will be applied towards refunding of a portion of the Monroeville Finance Authority series 2012 (UPMC). The series 2017C and 2017D-2 bonds will a variable rate remarketing to a new interest rate mode. The bonds will be sold via negotiation on or about April 4, 2022.

SECURITY

The bonds are secured by a gross revenue pledge of the obligated group (OG). The series 2022A, 2022B, 2017C and 2017D-2 bonds will constitute parity debt under UPMC's 2007 master trust indenture. The Insurance Division, which is not in the OG, but owned by the corporate parent, accounted for approximately 53% of 2021 system operating revenues (before eliminations).

ANALYTICAL CONCLUSION

UPMC's 'A' ratings and the revision of the Outlook to Positive are based on its leading market share position in its core markets of Allegheny County and Western Pennsylvania and solid presence in the larger service area that now encompasses Maryland and New York, materially improved capital related metrics due to positive liquidity growth over the last two years and the presence of a mature and profitable health plan, all of which support the improvement in UPMC's financial profile.

UPMC has demonstrated considerable growth in recent years, pursuing strategic investments to position the organization as an essential, innovative provider on both the clinical and health plan side. The strengthened leverage metrics supporting the Positive Outlook provide a solid platform for the system to continue to develop its long-term strategic plans, which Fitch expects could dampen UPMC's profitability to ranges more consistent with the pre-2020 level in the near term. Positive rating action would require that the somewhat lower profitability does not dilute the maintenance of the stronger leverage metrics over the next 12 to 18 months.

KEY RATING DRIVERS

Revenue Defensibility: 'bbb'

Revenue Defensibility Lead

Leading Market Position Enhanced by Insurance Plans

Revenue Defensibility

UPMC's significant credit strength continues to be its leading and growing market share in Allegheny County and the western Pennsylvania market. Fitch views UPMC's revenue diversification and integrated delivery model with its large aligned physician base, extensive health plan division and sizeable delivery network to be a material credit differentiator, and one which continues to significantly shift the market in Western Pennsylvania in UPMC's favor, as demonstrated by a percentage increase in its market share in 2021. The insurance plans are a source of revenue stability for the system while solidifying UPMC's health care presence in the state.

Operating Risk: 'bbb'

Operating Risk Lead

Weak Operating Margins Offset by Insurance Plans

Operating Risk

UPMC's operating EBITDA margins were somewhat higher during the last two fiscal years, partially benefiting from the CARES Act relief funding, as well as the sale of a portion of an infusion therapy and special pharmacy in 2020. Management expects that operating EBITDA margins in the near term will be more in line with the pre-2020 range of about 4.5% due to the persistence of the tight labor market and inflationary pressures, and the residual impact of the pandemic on some volumes.

Despite the expectation of lower profitability in the next several years, Fitch is assessing a mid-range overall operating risk profile given the accretive health insurance operations and still manageable capital needs that provide a fair amount of spending flexibility. Due to its sizable insurance division, which accounts for close to 50% of operating revenues, UPMC's operating cash flow margin is lower than that of provider-only systems due to the lack of depreciation expense related to the health plans.

However, Fitch believes that the presence of the now fully mature and profitable health plan provides an offset to potential revenue volatility in the provider division, as was evident during the recent two years under the pandemic conditions.

Financial Profile: 'a'

Financial Profile Lead

Gradually Improving Leverage Metrics

Financial Profile

UPMC's leverage metrics have gradually improved over the last two years. UPMC's liquidity had always been low vis-a-vis the system's debt position, but liquidity increased significantly in 2020 with debt proceeds and improved operating results in 2020 and 2021. The strong financial profile is based on operating EBITDA margins sustained at a minimum of 4.5% and UPMC's debt maintained at about the current level even with some level of future borrowing that would be offset by principal amortization.

Asymmetric Additional Risk Considerations

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

RATING SENSITIVITIES

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

--Sustained improvement in unrestricted cash-to-adjusted debt at a level better than 120%;

--Meeting Fitch's expectation for operating EBITDA margins in the mid-4% range.

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

--Margin compression below Fitch's current expectations;

--High capital spending that requires significant additional cash or debt commitments such that cash-to-adjusted debt falls below 120%.

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

UPMC is the largest health care system and non-governmental employer in Pennsylvania, as well as one of the largest integrated health care delivery networks in the country. It is also one of the world's leading organ transplant centers. With 40 hospitals and more than 700 clinical locations in the region, along with 5,200 employed physicians and 4.1 million covered lives in its network of health insurance plans, UPMC reported total revenues of over $24.4 billion in fiscal 2021.

Over the last four years, UPMC's revenue base, assets and liabilities have grown quickly with the growth of its health plans and targeted acquisitions. The system does not have any other acquisition targets at this time. In addition to its provider and insurance operations, UPMC operates a couple of hospitals internationally and it continues to invest in UPMC Enterprises, which focuses on emerging technologies in translational sciences and digital solutions.

Revenue Defensibility

Revenue Source Characteristics

Less than 20% of UPMC's gross patient revenue is represented by Medicaid and self-pay, supporting the 'bbb' assessment for revenue defensibility. UPMC is the largest medical insurer in Western Pennsylvania with approximately 32% of the insured market, up from 21% in 2014. All the other insurers account for roughly 33% of the market and Highmark represents 22% of the insurer market.

Fitch views favorably the close to 50% of UPMC's revenues being generated by its health plan division, which serves as a natural hedge as demonstrated during the past two years of the pandemic, which depressed volumes but allowed higher revenue generation from insurance premiums. Most of UPMC's commercial plan revenue originates from its own UPMC plans, with about 9% from Highmark Health's commercial contracts, although that number is expected to grow following the 10-year agreement entered into in 2019 between Highmark and UPMC that keeps most UPMC providers and hospitals in network for Highmark insurance plan enrollees.

Market Position

UPMC holds a strong and leading market share in the western Pennsylvania market with an estimated 61% share in Allegheny County, which has population of 1.2 million, and continues to maintain leading share of 45% of the 29 counties in western Pennsylvania including Allegheny County. Allegheny County is a competitive market served by two integrated delivery systems, UPMC and the Allegheny Health Network (AHN), the result of Highmark's affiliation with West Penn Allegheny Health System, but UPMC maintains the clear leading position and was able to increase its market share by a percentage point in the last year.

UPMC is continuing to strengthen market share in central Pennsylvania and has in recent years expanded into Maryland and western New York. With recent strategic acquisitions and affiliations, UPMC is well-positioned for a statewide strategic presence. The system continues to enhance its clinical offerings in regional strategies to attract higher acuity business and is developing innovative platforms to better respond and compete in a consumer-centric environment.

Service Area Characteristics

UPMC's 29-county service area has a population of approximately four million people. Its home county of Allegheny County has a senior population of almost 20%, driving higher demand for health care services. However, the area's overall population is flat to slightly declining, resulting from an absence of organic growth. Median income and poverty levels in the region are in line with those in the rest of the state and the U.S.

Operating Risk

Operating Cost Flexibility

UPMC's revenues continued to grow in fiscal 2021 to $24.4 billion, a 5.5% increase, partially driven by the growth in its insurance division. The system reported operating income of $843 million, equal to an operating margin of 2.8% and operating EBITDA margin of 6.3%, a slight decrease from the 6.6% operating EBITDA margin in the prior year. UPMC's volumes are gradually returning to pre-coronavirus levels, though the system experienced a big increase in coronavirus cases in the 2020-2021 winter months, as well as in late 2021, with COVID-19 spiking to 20% of inpatient census.

Additionally, the system was experiencing staff retention challenges and pressures, driving higher salary expense, which included significant merit increases and a $50 million employee appreciation bonus in 2021, as well as higher medical expenses ratio from higher medical claims expense. Operating revenues in 2021 included $264 million from the CARES Act relief funding; in 2020 UPMC recorded $380 million under the Act.

Fitch continues to believe that UPMC's strong market position and scale provide the system with the opportunity to better manage its own rates and expenses within its integrated network in the long run, but the next several years will be decisive in determining whether the system can attain higher levels of profitability, though not likely at the level of the last two years.

In the meantime, UPMC is focusing on further improvements from eliminating variation throughout its care settings, site utilization and maximizing regional hubs, consolidating support structure and administration, and improving access through more responsive appointment scheduling, as well as optimizing medical claims; all of which are ongoing efforts. UPMC has also instituted an innovative staff retention model based on a performance ladder, and has launched its own travel agency, but anticipates that the nationwide staff dislocation will take a couple of years to return to a steadier state.

Capital Expenditure Requirements

After scaling back capex in 2020 and 2021 to around $800 million, UPMC is now projecting to increase capex spending to about $1 billion to $1.2 billion in 2022 and 2023 before capex normalizes to around to $1 billion (approximately 1.2x depreciation) in the outer years of Fitch's five year forward look. The system's capex investment includes $2 billion in support of two large strategic projects planned or underway for a 650-bed tower at UPMC Presbyterian (construction starting summer 2022), a nine-story UPMC Vision and Rehabilitation Tower at UPMC Mercy (completion spring 2023), as well as a number of smaller expansions and ambulatory projects throughout UPMC's service areas.

UPMC's routine capital for construction and information technology (IT) is now over $400 million annually with another $225 million in capital commitments related to recent acquisitions. UPMC has some capex flexibility with manageable capital needs and a healthy average age of plant of 9.7 years as of the end of 2021, with capex averaging close to 130% of depreciation over the last five years.

Financial Profile

Fitch Case Analysis

UPMC reported cash and unrestricted investments at $8.6 billion at Dec. 31, 2021, with Fitch excluding the $515 million in Medicare advanced funds and $104 million in payroll tax deferrals. The liquidity position translates to 136 days cash on hand (DCOH), an improvement from 93 DCOH at YE 2019. Fitch has historically factored into its analysis the fact that UPMC's insurance division, which generates close 50% of the consolidated system operating revenues/expenses, essentially reduces DCOH due to the medical claims flowing through its expense base.

At 2021 FYE, UPMC's cash-to-adjusted debt equaled 132% and net adjusted debt to adjusted EBITDA (NADAE) was favorably negative at 0.9x. No adjustments are made to the $6.5 billion debt in Fitch's adjusted debt metrics as UPMC's pension is funded at a high 101% level and operating lease expenses are reflected as a liability on its balance sheet.

Fitch's forward-looking scenario assumes a portfolio stress of 12.6% for UPMC's unrestricted investments in year one before returning to investment returns of approximately 5.4% in the later years. Assuming that operating EBITDA margins are sustained at a minimum 4.5% and that no new debt is issued over the five-year period, cash-to-adjusted debt will meet the 120% cash-to-adjusted debt threshold and NADAE will be in a favorably negative position in the outer years of Fitch stressed case scenario, which is consistent with the 'a' financial profile in the context of a midrange revenue defensibility and midrange operating risk profile.

Asymmetric Additional Risk Considerations

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

Sources of Information

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 www.fitchratings.com/esg.

RATING ACTIONS

ENTITY / DEBT	RATING		PRIOR
UPMC Health System (PA)	LT IDR	A Rating Outlook Stable Affirmed	A Rating Outlook Stable
UPMC Health System (PA) /General Revenues/1 LT	LT	A Rating Outlook Positive Affirmed	A Rating Outlook Stable

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Eva Thein
Senior Director
Primary Rating Analyst
+1 212 908 0674
eva.thein@fitchratings.com
Fitch Ratings, Inc.
Hearst Tower 300 W. 57th Street New York, NY 10019

Kevin Holloran
Senior Director
Secondary Rating Analyst
+1 512 813 5700
kevin.holloran@fitchratings.com

Margaret Johnson, CFA
Director
Committee Chairperson
+1 212 908 0545
margaret.johnson@fitchratings.com

MEDIA CONTACTS

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

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 (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), v1.3.3 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Maryland Health & Higher Educational Facilities Authority (MD)	EU Endorsed, UK Enc

DISCLAIMER

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS. IN ADDITION, THE FOLLOWING HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST,

AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE OR ANCILLARY SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF PERMISSIBLE SERVICE(S) FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) OR ANCILLARY SERVICE(S) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

READ LESS

COPYRIGHT

Copyright © 2022 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the

particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.
The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such

fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO’s credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

US Public Finance   Healthcare and Pharma   North America   United States

---