Article Title: Criteria | Governments | U.S. Public Finance: Human Service Providers Data: (EDITOR'S NOTE: —On April 26, 2021, we republished this criteria article to make nonmaterial changes. See the "Revisions And Updates" section for details.) 1. Human service providers serve individuals who have development disabilities or are suffering from mental illness, and who typically need substantial support to function at their highest level. The human service providers support their clients with distinct programs to meet distinct challenges. Criteria 2. The following rating approach is applicable to quasi-governmental providers and freestanding traditional nonprofit community agencies. A provider's organizational model, governmental relationship, and type of service provided, among other factors, will be given greater or lesser weight, depending on each situation. Due to the constrained reimbursement systems in which the providers operate, and the generally weak reserves held by these organizations, ratings tend to range from high speculative-grade ('BB' level) to medium investment-grade ('A' level). 3. Major factors in S&P; Global Ratings' review usually include: Service essentiality; Provider assessment; Management quality; Financial analysis; Funding agency relationship; Fund raising history; and Pledged security and legal structure. Essentiality 4. The most important factor is essentiality, which incorporates the likelihood that government, through funding agencies, will continue to fund certain critical services. Because many human service providers have break-even operations and limited liquidity, S&P; Global Ratings relies on strong service essentiality to boost credit quality. 5. The courts have mandated community-based treatment for developmental disabilities and mental health, making these services essential. On the other hand, chemical dependency programs as well as day care and training programs receive less support from the judiciary, government, and the public. Therefore, S&P; Global Ratings views these services as less essential as well. However, if a provider can demonstrate a history of funding support for less essential services, this would be a positive factor in the rating determination. A history of funding support by leading state or local agencies through good and bad times is also a positive factor. The provider 6. S&P; Global Ratings looks at two key items when assessing the provider: An analysis of services provided and the provider's market position. 7. It is best if services are self-supporting from their funding sources with a minimum of subsidization from investment income or contributions. A broad array of services offered to a variety of populations minimizes the impact of funding reductions or market forces in one or two particular service lines. However, if taken to the extreme, this strategy can expose the provider to additional risk if lines of business are new and unproven, or do not complement other service offerings. For example, if a provider takes on a highly specialized treatment, such as services for severely autistic children, without prior or related experience, this can expose the provider to additional risk. S&P; Global Ratings also reviews geographic diversity, which can diversify funding and market risk. However, there is additional risk if the provider's service area is too large to manage, or so small that it is vulnerable to competition. 8. S&P; Global Ratings' analysis of market position seeks to understand the provider's importance in a service area. A dominant market position, including largest number of clients served, most contracts received, or high barriers to entry in a specific service niche are favorable factors. S&P; Global Ratings seeks to understand market penetration, contracts received and lost, as well as competitors' strengths and weaknesses. Of particular concern is the entry of for-profit providers in a market. In addition, it can be difficult to assess the competition since measurable units of output and cost are not standard and often not measured within the industry. Management 9. The quality of management affects various factors in S&P; Global Ratings' credit evaluation. Management's history and track record, its ability to maintain a viable organization and strategically move it toward the future are part of S&P; Global Ratings' analysis. Evidence of an experienced management team, one not reliant on one or two people, is a strength. S&P; Global Ratings generally assesses the sophistication of management practices by analyzing strategic plans, use of cost measures, and standard procedures. S&P; Global Ratings will also investigate the strength and oversight of the board of trustees. Where appropriate, accreditation by national bodies, such as the Commission on Accreditation of Rehabilitation Facilities, can indicate compliance with professional standards. In addition, the level and degree of state oversight is especially important given overall state mandates to provide these services. Financial analysis 10. Financial analysis, similar to that for revenue bonds, emphasizes a strong track record of financial viability that allows the organization to make timely debt service payments. This includes an historical analysis of utilization and types of contracts, and how these contribute to profitability. S&P; Global

Ratings looks at referral patterns to gauge whether major referral sources can be expected to continue. S&P; Global Ratings will often ask about service backlogs, such as a waiting list. Since providers have minimal price flexibility, S&P; Global Ratings emphasizes cost control in its analysis and usually looks for treatment costs on a per-client basis. S&P; Global Ratings also asks providers to discuss examples of historical problems affecting finances, management, funding and treatment, and how they were remedied. 11. Revenue and income trends are reviewed including operating and excess margins, debt service coverage and the overall debt burden of the organization on a historical as well as pro forma basis if new debt is being issued. Liquidity and debt structure are also important to determine the provider's flexibility and cushion against future events. Various liquidity measures, including unrestricted days cash on hand as well cash to pro forma debt are two important metrics as well as various measures of overall leverage. Most human service providers are not highly profitable organizations, and margins are generally not as high as for comparably rated health care providers. Some providers rely on gift income to balance operations. 12. An established fundraising program, and a steady stream of bequests and fundraising can sometimes offset weak operating performance if similar levels are achieved on a recurring basis. However, over time, most organizations rated by S&P; Global Ratings are able to break-even based on program revenues alone. The presence of an endowment can provide a steady source of operating income for some providers. In this case, S&P; Global Ratings generally asks about whether there is a standard spending policy that can provide some operational stability, or whether the endowment is only used to cover operating deficits that might occur. Funding agencies 13. An integral component of the provider's financial strength is its relationship with the funding agencies, the major sources of revenues. Since providers often rely on one-year renewable funding contracts, it may be difficult to assess revenue-stream quality. S&P; Global Ratings generally speaks directly with the major funding agency in order to understand several key points about the durability and strength of major contracts. These points include: The nature of the contracts with the provider; How contracts are awarded and renewed; The history of cancellation and funding cutbacks; and The day-to-day working relationship with the provider. 14. S&P; Global Ratings usually reviews the nature of the contracts and their award procedures to evaluate the competitiveness of the process. S&P; Global Ratings favors contract renewals based on performance, not price, because the former supports financial and treatment stability. If contracts are frequently canceled, S&P; Global Ratings will be concerned about the quality of the selection process as well as the quality of the agency's revenue stream. Cancellations will be unlikely when there are strong cooperative relationships between the agencies and providers. In addition, the use of various types of intercepts from different funding programs can potentially provide credit enhancement. Legal and security provisions 15. The legal and security provisions are also often similar to those found in revenue bond financings. In general, the provider's entire revenue stream will be pledged and assigned to the payment of debt service. Other legal provisions often present include a debt service reserve funded at maximum annual debt service, appropriate security pledge, and assurances that providers have made provision for successors to meet debt service payments. Providers are also expected to maintain investments that are appropriate for the size and type of organization. Revisions And Updates This article was originally published on June 13, 2007. Changes introduced after original publication: Following our periodic review in 2016, we added the "Related Criteria And Research" section and updated the contact list. Following our periodic review completed on June 9, 2017, we updated the contact list. Following our periodic review completed on June 8, 2018, we updated the contact list. On July 31, 2019, we republished this criteria article to make nonmaterial changes to the contact information. On July 27, 2020, we republished this criteria article to make nonmaterial changes. We updated our contact list and criteria references. On April 26, 2021, we republished this criteria article to make nonmaterial changes. We updated the contact information and criteria references. Related Publications Related Criteria Group Rating Methodology, July 1, 2019 Assigning Issue Credit Ratings Of Operating Entities, May 20, 2015 Criteria For Assigning 'CCC+', 'CCC', 'CCC-', And 'CC' Ratings, Oct. 1, 2012 Contingent Liquidity Risks, March 5, 2012 Principles Of Credit Ratings, Feb. 16, 2011 These criteria represent the specific application of fundamental principles that define credit risk and ratings opinions. Their use is determined by issuer- or issue-specific attributes as well as S&P; Global Ratings assessment of the credit and, if applicable, structural risks for a given issuer or issue rating. Methodology and assumptions may change from time to time as a result of market and economic conditions, issuer- or issue-specific factors, or new empirical evidence that would affect our credit judgment.