

# Beyond Bailouts and Healthcare Reform: Moving Forward With Capital Financing for Projects

Lunch and Learn Webinar

August 18, 2011



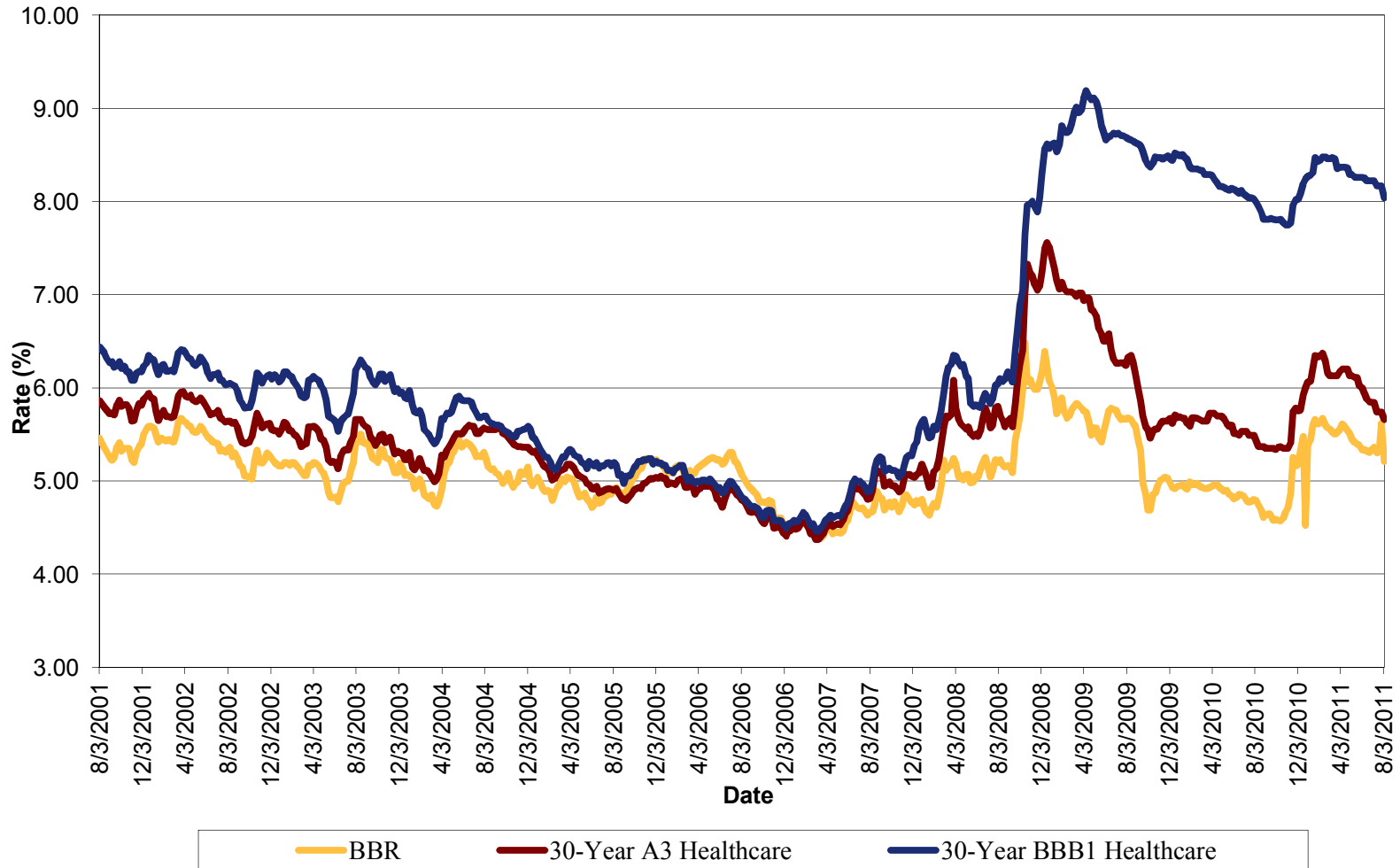
# Agenda

- Hospital Credit Environment
- Capital Funding Options
  - Government Resources
  - Bank Resources
  - Capital on your Own Strength
    - Antelope Valley Hospital Case Study
    - Two Non-Bank Hospital Case Studies
- Questions?



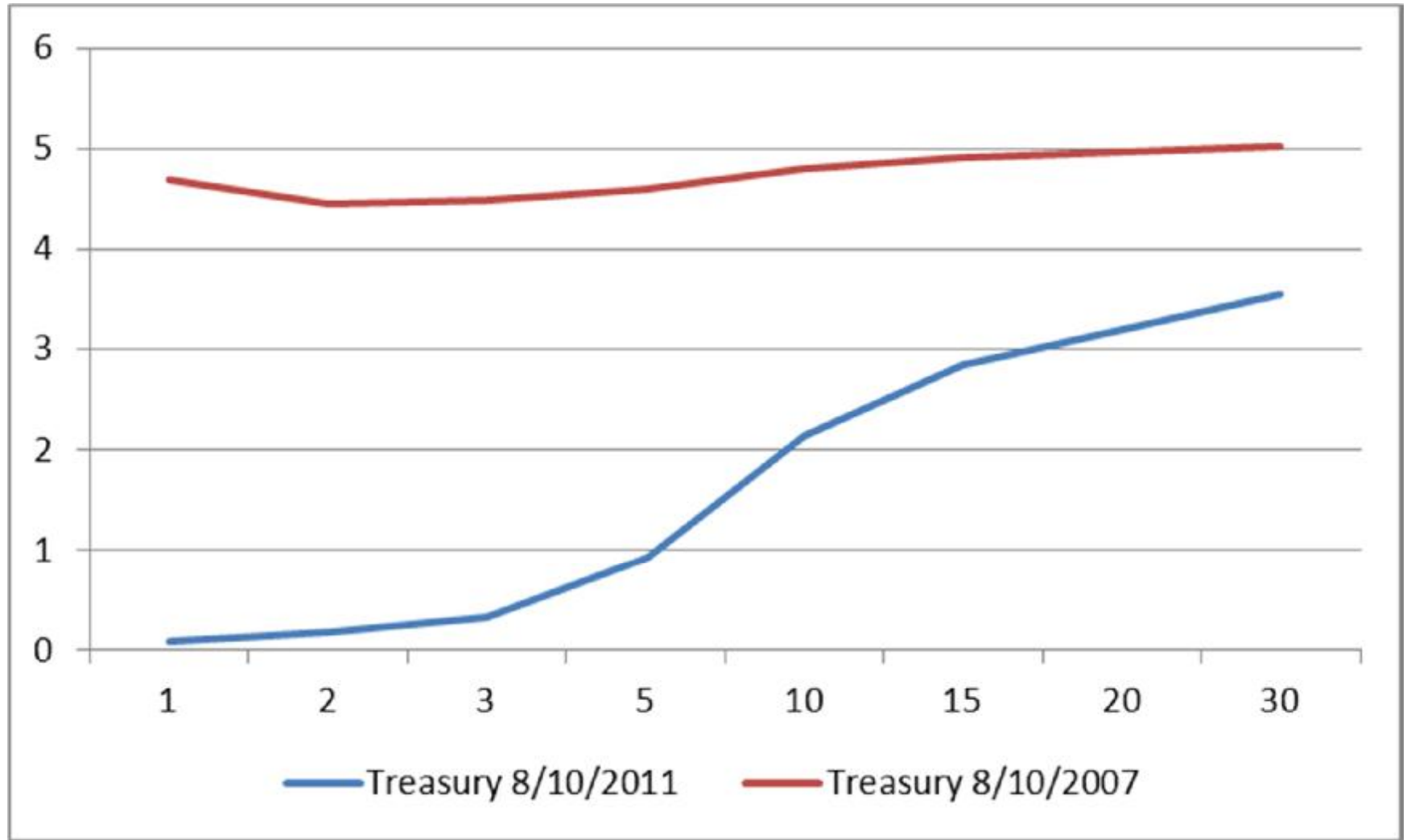
*Sometimes  
you can't afford to wait  
for optimal market conditions.*

# Healthcare Credit Timeline



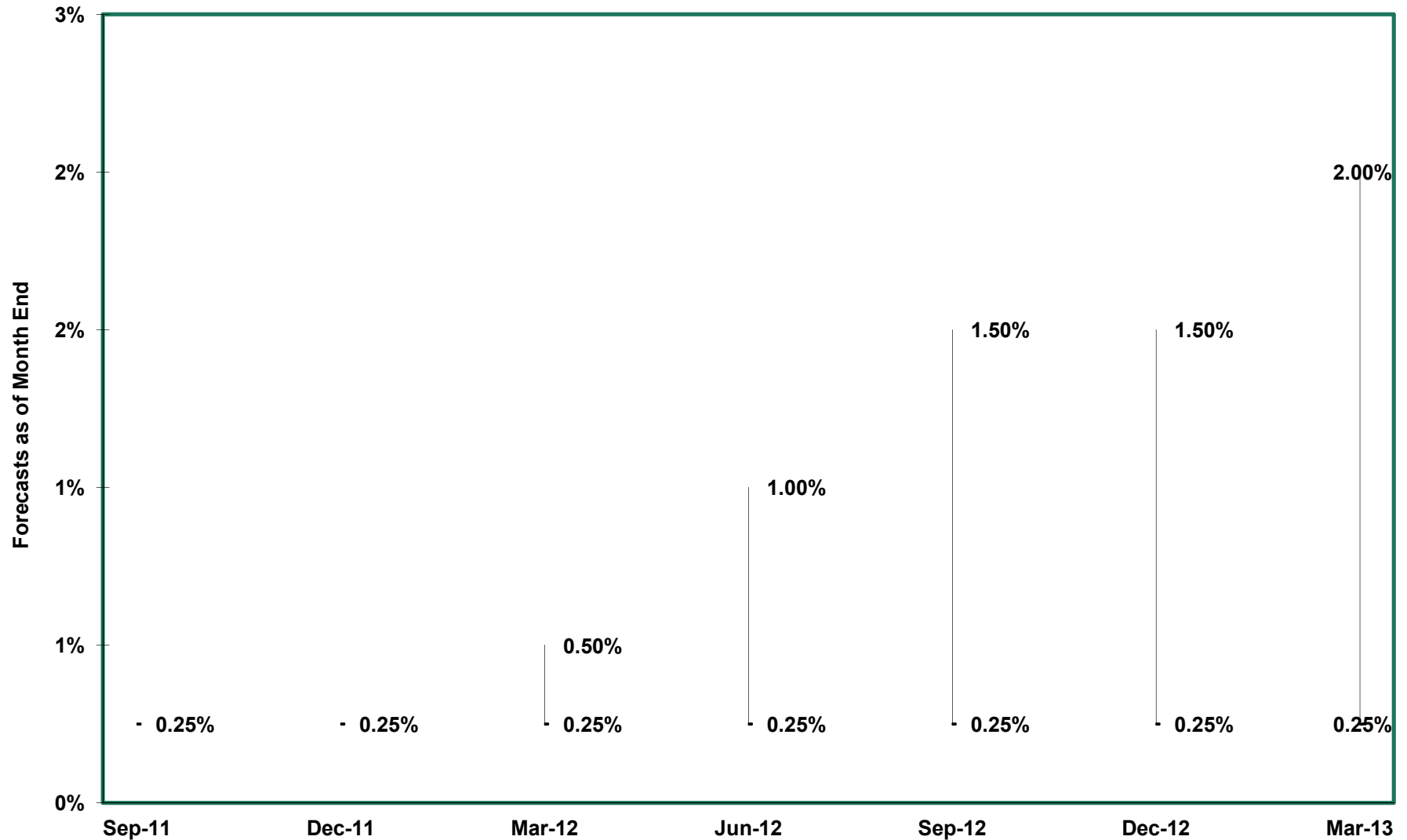
Rates through 8/3/2011 via Bloomberg

# Yield Curve 2007 vs. 2011



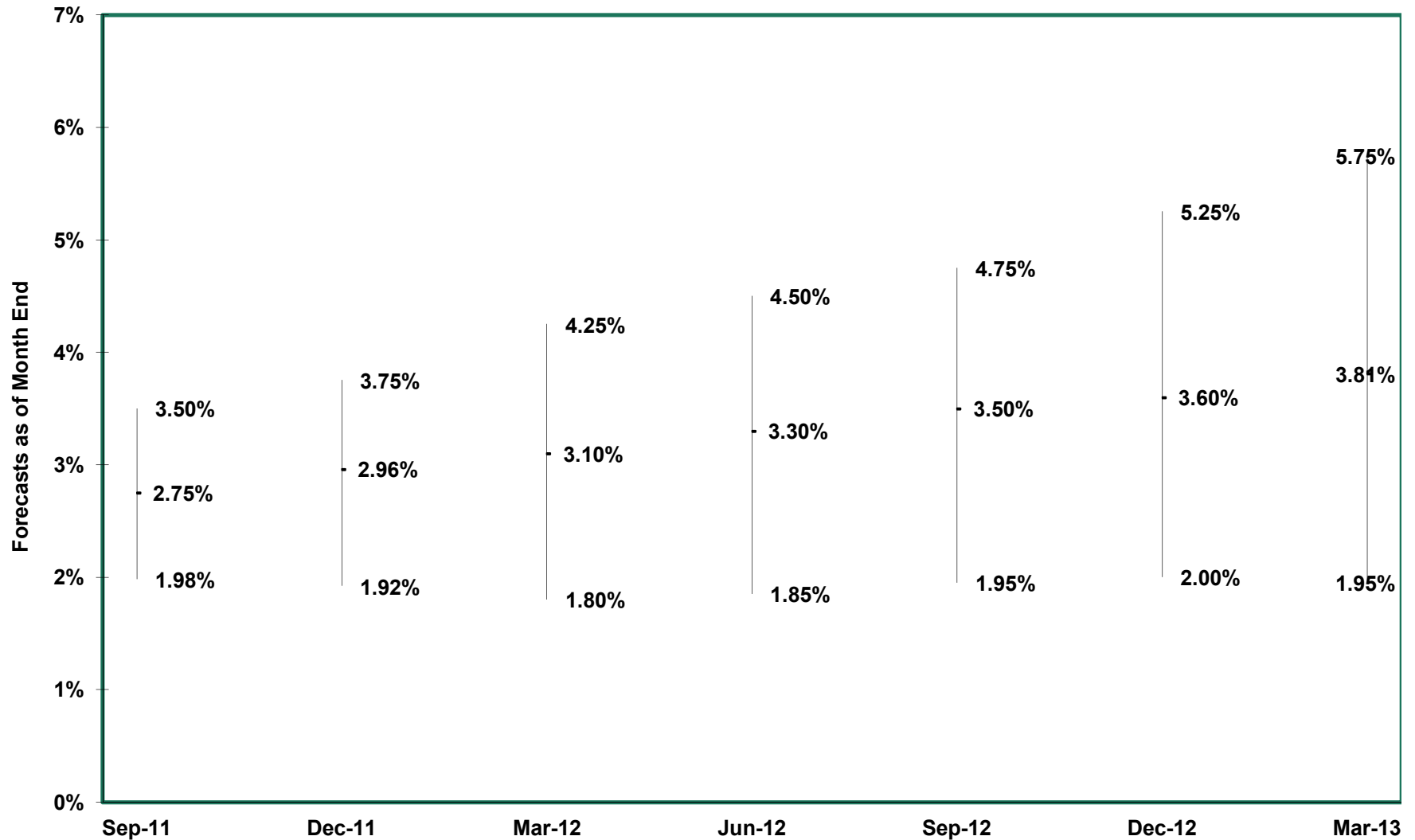
Thompson Data as of August 10, 2011

# Forecast: Target Fed Funds Rate



Source: Bloomberg Survey, August 12, 2011

# Forecast: 10-Year Treasury Yield

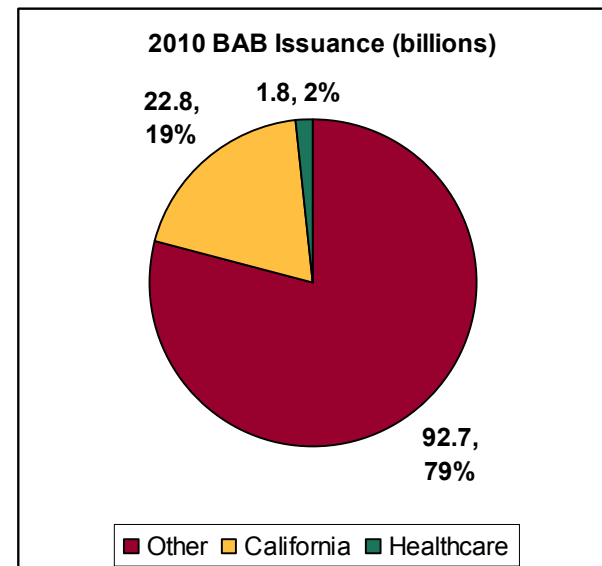
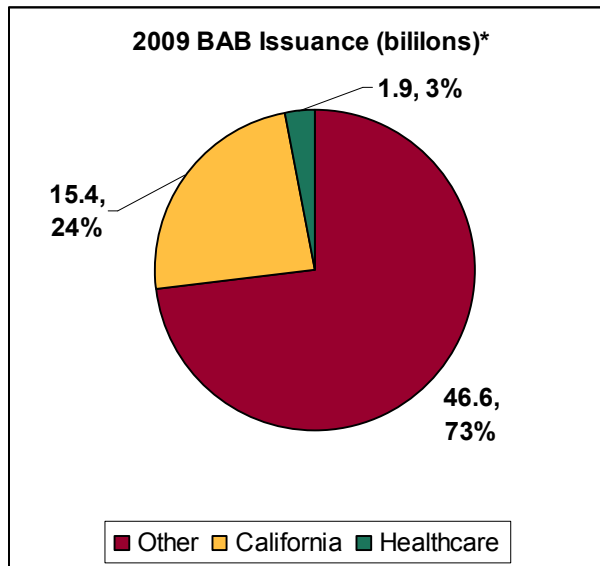
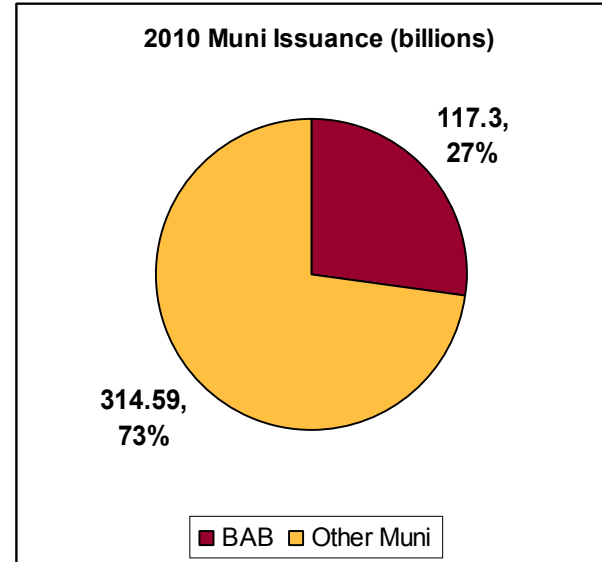
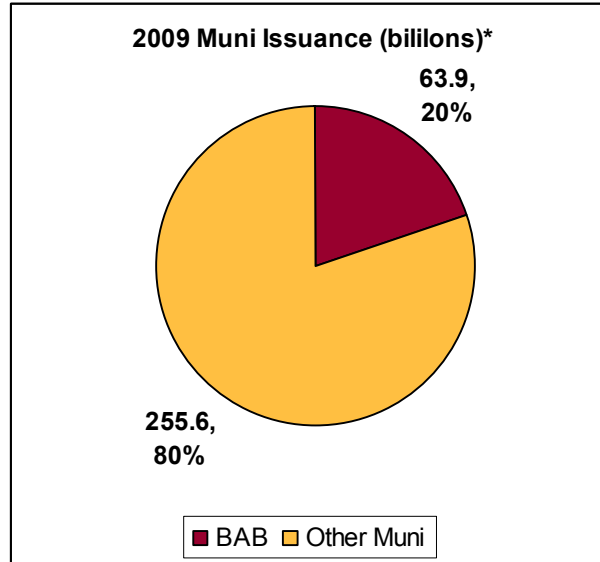


Source: Bloomberg Survey, August 12, 2011

# Muni Market Timeline

- In December of 2010 Meredith Whitney, a prominent analyst who predicted the fall of Citigroup, went on 60 minutes and stated that fifty to one hundred “sizable” cities and counties would default on their debt.
  - Moody’s counts only 54 bond defaults over a 39 year period
- Municipal bond issuance down this year – Through July volume is down 40% from last year
  - Estimated to be \$250 billion this year compared to \$400 billion in a typical year
- Yields have improved since 1<sup>st</sup> Q 2011 as dearth of healthcare credits and large supply of purchasing power converge
- US Debt Ceiling Raised on August 2<sup>nd</sup>
  - As a result many predicting 2% reduction in Medicare payments to providers
- S&P downgrades U.S. sovereign rating on August 5<sup>th</sup>
- **Uncertainty has been a major theme in the muni markets**

# Build America Bond Impact



\* SIFMA Data From April 15<sup>th</sup> (the closing of the first BAB deal) to December 31

# Rating Agency Views Healthcare Reform Bill

- Passed March 23, 2010
- Rating Agency Views on Reform
  - 2011 relative stability expected to continue
  - “S&P closely monitoring (3 to 5 year horizon):
    - Payment Reform
    - Delivery Reform
  - Reform will expand coverage, not reduce costs
  - Fitch’s predicting highly aligned health care organizations to take advantage of scale
  - Increase in merger activity

# Recent Rating Commentary

- Data below from S&P 2011 rating report published on August 2
- U.S. not-for-profit health care sector will remain stable for remained or 2011
  - Robust cost containment
  - Efforts to gain economies of scale, market share and
  - Revenue enhancements including focus on service line management
- Providers will have a harder time offsetting an increasingly hostile environment
  - Continued weaker revenues,
  - Ongoing volume issues and declining insurance coverage, and
  - Uncertainties about the implementation of healthcare reform
  - Emerging uncertainty about new federal reductions in debt ceiling agreement
- Broad pressure on all rating categories over the medium to long term

# Recent Rating Commentary

- Data below from S&P 2011 rating report published on August 2
- Unrestricted liquidity strengthened for almost all rating levels
  - Reduced capital spending
  - Rising investment valuations
  - Healthy cash flow
- Improved non-operating income (mostly investment earnings) contributed to increased cash flow and debt service coverage across almost all rating levels
- The median trends and recent ratings actions support our near term stable outlook for the sector in 2011, although the uncertainty of health care reform and related operating pressures make the medium to long-term outlook more challenging

# Recently Priced Public Offerings

Full 250 bed replacement hospital for Community Memorial Health System in Ventura. Deal priced on 8/1/2011

SAN BUENAVENTURA HLTH SYS		ST: CA	TAX: FED & ST TAX-EXEMPT		View Attachments	
Summary		MATURITY	AMT(M)	CPN	P/Y	CUSIP
Amount	350,000,000.00	1) 12/16	5080.0	5.000	5.110	797049AA1
Sale Date	08/01/11	2) 12/17	5330.0	5.250	5.470	797049AB9
MGR	BANC OF AMERICA M...	3) 12/18	5610.0	5.750	5.850	797049AC7
Bond Type	REVS	4) 12/19	5935.0	6.000	6.180	797049AD5
Dated	08/17/11	5) 12/20	6290.0	6.250	6.440	797049AE3
1st Coupon	12/01/11	6) 12/21	6685.0	6.500	6.620	797049AF0
Rating/Enhancement		7) 12/22	7120.0	6.500	6.750	797049AK9
Moody's	Ba2e	8) 12/26	29085.0	8.000	7.200	797049AG8
S&P	APPLIED	9) 12/26	5000.0	7.000	7.200	797049AL7
Fitch		10) 12/31	60275.0	8.000	7.400	797049AH6
ENH		11) 12/41	213590.0	7.500	7.650	797049AJ2
Schedules						
Prem Call						
Par Call	12/01/21					ERP
Other Notes						
1st Settle	08/17/11					
BOOK-ENTRY,DTC						
PRICE STATUS REPRICED						
DENOMS: \$100,000/\$5,000						
COMMUNITY MEMORIAL HEALTH SYSTEM						

# Recently Priced Public Offerings

Hospital	State	Amount	Rating	Final Maturity	Long Bond Yield	Closing Date
St. Peters	New Jersey	\$100,640,000	BBB-	7/1/2035	6.375%	8/1/2011
University Med. Center	Arizona	\$73,275,000	BBB+	7/1/2039	6.12%	8/9/2011
Maine General	Maine	\$280,750,000	BBB-	7/1/2041	7%	8/11/2011
Choctaw County*	Mississippi	\$13,500,000	BBB+	8/1/2031	7.75% (taxable)	8/1/2011

\* Backed by County

# Market Conditions Summary

- Investors are scrutinizing health care credits more.
- Variable interest rates remain very low historically
- Rate pricing remains volatile for both fixed and variable
- Public market has improved recently for unenhanced bond issue
- Municipal market has remained resilient during last couple of weeks

Therefore

Unrated and lower rated hospitals may need credit enhancement to access public capital markets.

Hospitals should consider pursuing multiple financing options in parallel when coming to market

# Summary: Where Can Hospitals Turn?

## Bank Resources

- Commercial Banks
- Direct placement of bonds
  - Bank-qualified bonds
- Letters of Credit
  - Federal Home Loan Bank
  - Regional Banks
- Specialty hospital financing companies

## Government Resources

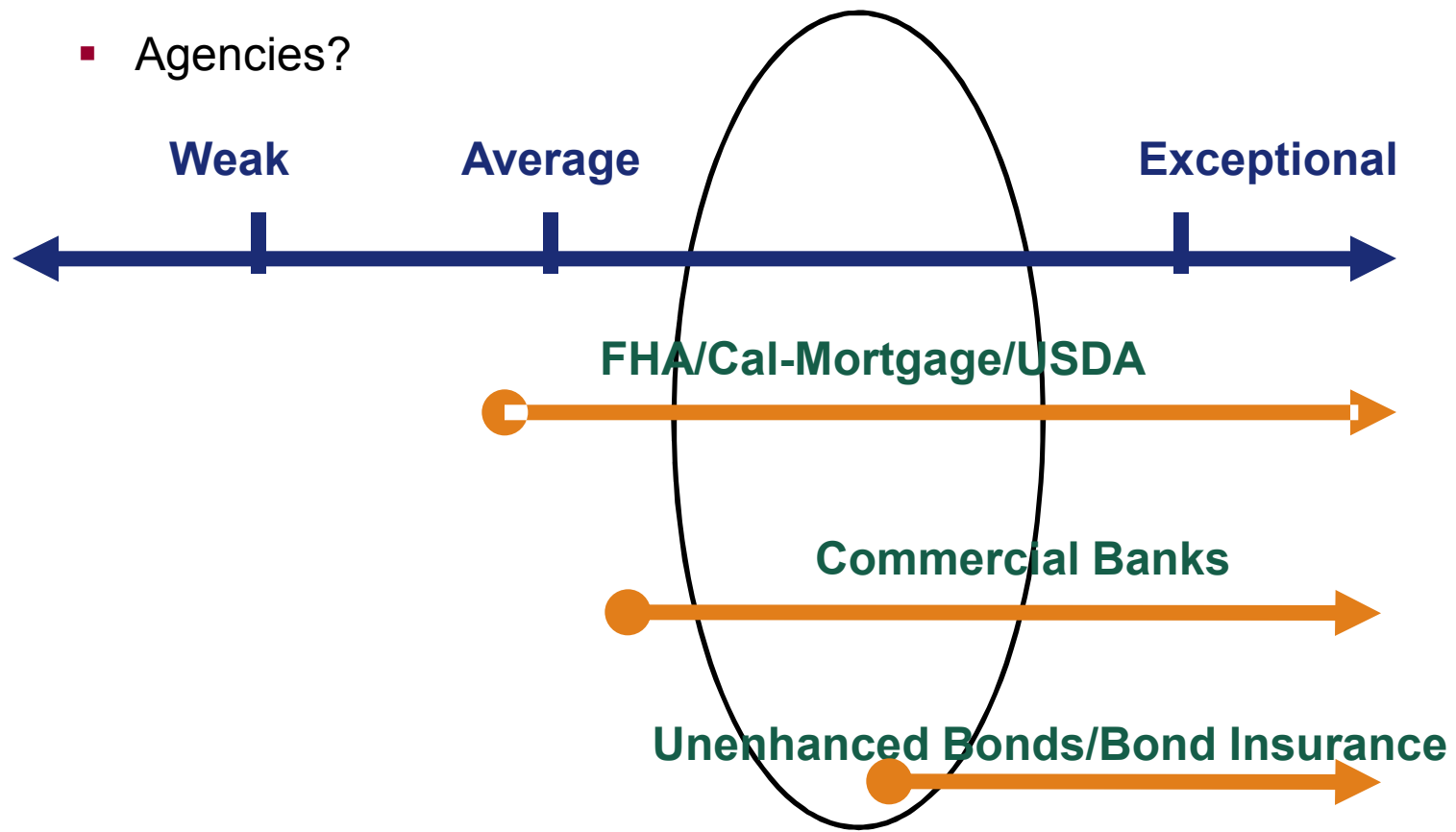
- USDA Program
- FHA-insured/HUD mortgages
- Cal-Mortgage

## On Your Own or With Internal Resources

- Unenhanced bonds
- Tax-backed bonds
- Hospital system guarantee

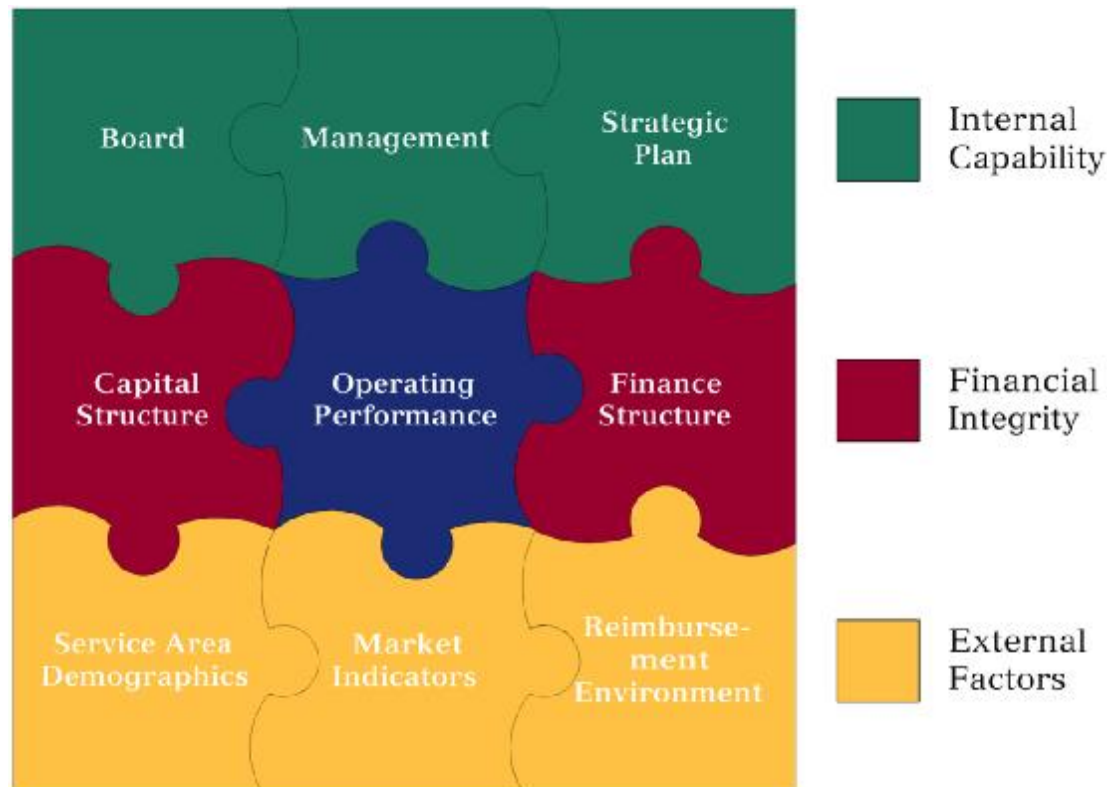
# The Current Credit Profile Continuum

- After the last couple of years who is still lending?
  - Banks? Non-Conventional Lenders?
  - Unenhanced Bonds?
  - Agencies?



# Credit Profile Criteria

- Effectively communicating the organization's credit story has a direct impact on pricing / structure.





# Enhanced Options

# FHA-Insured Mortgage: FHA Sec. 242

- For new construction, renovation, refinance
- For hospitals of all sizes
- Program is cash flow based
- Program historically concentrated in northeast but is looking for geographical diversification
- Requires a mortgage

## Pros

- AAA or AA interest rates
- Pricing is a flat 0.5% annually
- Special criteria for critical access hospitals
- Up to 25 years amortization
- No renewal risk
- No financial covenants
- Non-recourse to system

## Cons

- Must meet financial eligibility tests
- Longer lead time to close
- Davis-Bacon union wages

# North Canyon Medical Center



- Replacement CAH in Gooding, Idaho
- Affiliated health system wanted new project financed separately from obligated group
- At the time, even stronger systems were pricing tax-exempt bonds at a much higher 8.5%.
- State limited tax-exempt financing options so the deal was funded with taxable notes

## FHA-insured Sec. 242 Program

- \$27.6 million
- Rate of 6.75% for 25 years
- AAA-equivalent credit rating
- Non-recourse to system
- Saved an estimated \$14,000,000 in principal and interest costs over life of loan



# USDA Programs for Rural Hospitals

## Community Facilities Program

- |  |   |
|--|---|
| <ul style="list-style-type: none"><li>▪ Direct and guaranteed loans, with some limited grants</li><li>▪ Term up to 40 years</li><li>▪ 90% guaranteed</li><li>▪ Cannot use for 100% refinance</li></ul> | <ul style="list-style-type: none"><li>▪ Fixed or variable rates</li><li>▪ No min/max loan amount</li><li>▪ <b>For populations of &lt;20,000</b></li><li>▪ One-time 1% guarantee fee</li><li>▪ Loans are taxable</li></ul> |
|--|---|

## Business & Industry Program

- Guaranteed loans for projects that create or save rural jobs
- \$10 million max
- **For areas with populations of <50,000 people**
- Fixed rates for up to 30 years
- Up to 90% guarantee
- 2% upfront guarantee fee, plus 0.25% fee annually
- Fixed or variable rates

# Fairfield Memorial Hospital



- New Medical Office Building – 25,000 sq. ft medical arts complex
- Renovations to existing facility
- Had letter of credit bid from regional bank but it was pulled during credit crunch
- Local bank was able to increase loan amount due to USDA guarantee
- Other local city grants and co-op loans rounded out financing

## USDA Community Facilities

- \$8.2 million
- All-in interest rate of 4.61%
- Closed May 2010
- \$2.4 M USDA direct loan, \$4.2 M USDA guaranteed, \$1.6 M local loans
- 20-year amortization on guaranteed, 30 on direct



# Cal-Mortgage Program

- State provides bond insurance
- Upfront premium is based on credit rating
- Over 500 facilities and \$6 billion in loans since 1972
  - 32% hospitals
- Mortgage required

## Pros

- California currently rated A-
- Can be used for both new construction and refinance
- Fixed or variable rates
- Long 25- or 30-year terms

## Cons

- Longer lead time to close
- Material premium costs

# Bond Insurance

- No AAA rated insurers left
- Assured Guaranty currently only game in town and is AA+ rated
- Upfront premium is based on credit rating but Assured is only insuring rated credits
- Market has significantly slowed and contracted

## Pros

- Fixed Rate for life of bonds
- Can be used for both new construction and refinance
- Fully Amortizing
- Long 25- or 30-year terms

## Cons

- Material premium costs
- Only available to rated and larger credits
- Lockout provisions



# Commercial Bank Options

# Private Bank Placements

- Bank-qualified designation can increase bank interest in buying
  - As of Dec 2010 levels have returned to \$10MM per issuer/year
- Capitalize on local relationships
- Requires knowledge of local, national, and international banks' investment interests

## Pros

- Limited public disclosure and administrative paperwork
- Flexible terms
- Draw-down construction bonds can reduce costs

## Cons

- Must fit with bank's needs
- Limited long term fixed-rate options
- Difficult for projects >\$15M
- Refinance risk present

# Beatrice Community Hospital



- Replacement hospital
  - Investment grade
- Public investment market did not exhibit strong demand
- Had strong local support
- Included local banks in the offering
- Utilized temporary ARRA provisions increased BQ limits

## Rated, Unenhanced, Bank-qualified Bonds

- \$45 million issued in two calendar years under higher Recovery Act limits
- Tax-exempt
- Rated BBB-
- Bond rates between 6-6.75%



# Letters of Credit

- Hospital pays a bank for the right to borrow based on the bank's credit rating.
- Federal Home Loan Bank may be able to further enhance a local bank's taxable letter of credit – AA+ rates possible
- Can synthetically fix the interest rate

## Pros

- Great flexibility to adapt debt for future plans
- Can strengthen bank relationships
- No prepayment penalties

## Cons

- FHLB enhancement for taxable loans only
- Renewal risk
- Highly dependent on bank strength and whims

# Hopedale Medical Complex



- Current bank decided not to renew letter of credit
- Solution had to be flexible and allow early termination because of pending \$20M project
- Had bank loan offer but amended structure to FHLB letter of credit
  - FHLB saved \$100k over 15 months vs. direct bank loan.
- Local bank remained involved

## Federal Home Loan Bank Letter of Credit

- \$5.5 million refinance
- Variable rate resets weekly
- Low enhancement cost
- No prepayment penalty
- AA+ FHLB rating





# Specialty Finance Company Options

# Asset-Based (A/R, Revolver)

- Hospital establishes a revolving line of credit based on the value of its receivables.
- Hospital may borrow, repay, and re-borrow as needed over the life of the loan (efficient).
- Advance rates are typically 70%-85% of the net collectible value of receivables aged 120-180 days.

## Pros

- Interest only
- No DSRF
- Low carrying costs
- Flexible use of proceeds
- Lender patience
- No credit enhancement
- For-profit or non-profit

## Cons

- Short-term (1-5 yrs)
- Variable rates
- Taxable
- Lockbox and compliance
- Financial covenants/reporting

# Cash-Flow (Term Loan)

- Hospital establishes a term loan based on a multiple of cash flow, typically EBITDA. Able to fix interest rate synthetically.
- Borrowing multiple typically ranges from 1x to 4x EBITDA based on various factors including credit worthiness, revenue size and enterprise value, underlying security, (equipment, real estate, etc), etc.

## Pros

- Variable or fixed rates
- Medium-term, 3-7 yrs
- Financial covenants
- Market-driven

## Cons

- Prepayment penalties
- Potential swap breakage costs (if fixed rate)
- Amortization and/or excess cash flow sweep
- Taxable
- Audited financials
- Lender patience

# For-Profit Surgical Hospital in CA

- High-end surgical hospital with top patient satisfaction ranking and strong recent financial trends but storied history, no historical audited financials.
- Repay subordinated note owed to general partner to lower interest costs
- Solution was a hybrid structure (A/R revolver + term loan) with go forward audit

## Revolving Line of Credit

- \$5.0 million
- A/R advance of 85% to 150 days
- 90-day LIBOR + 375
- LIBOR floor 125
- 50bps unused line fee
- 50 bps admin fee

## Term Loan

- \$8.0 million
- 90-day LIBOR + 600
- LIBOR floor 125
- 84-month amortization
- Minimum FCC 1.25x

# Greenfield Acute Care Hospital

- 100-150 bed newly built for-profit acute care hospital in Riverside County majority owned by non-profit
- Operating losses from startup operations, significant working capital requirements – could not drop bills for Medicare and Medi-Cal until provider numbers approved

## Revolving Line of Credit

- \$20.0 million
- A/R advance of 85% to 180 days
- Lent against A/R pending applicable provider number tie-in notices, subject to cap
- 90-day LIBOR + 375
- LIBOR floor 125
- 50bps unused line fee
- 50 bps admin fee



# Unenhanced Public Offering

# Unenhanced Fixed-Rate Bonds

- Can be tax- or revenue-backed.
- Interest rate is based on a hospital's credit profile and, if tax-supported, by the municipal credit rating.

## Pros

- No enhancement fees
- Fully amortizing structure
- Fixed rate for life of the loan

## Cons

- Prepayment limitations
- Locks in current credit profile
- Debt service reserve fund
- Large interest rate gap between investment-grade and non-IG borrowers

# Antelope Valley Healthcare District



- 420 bed acute care regional medical center in Lancaster, California
- Rated Baa3 by Moody's and BB+ by S&P
- Management successfully recently turned around operations
- Utilized multiple structures to remain flexible and successfully closed a financing in a difficult market environment

## Rated, Unenhanced, Revenue Bonds and a Private Placement

- \$43.725 MM total project
- \$25MM 10 year private placement
- \$18.725MM unenhanced bonds with 25 year maturity
- Tax-exempt
- Bonds Rated Baa3

# Antelope Valley Healthcare District



- Project
  - Construction of new cardiac cath lab
  - Remodeling and expansion of imaging department for MRI and CT expansion
  - Remodeling of outpatient blood draw center
  - Relocation of clinical laboratory
  - Seismic renovations at SPC-1 buildings
  - Redemption of \$10MM of existing indebtedness

**ANTELOPE VALLEY HOSPITAL**  
**Finance Committee**  
**Comparison on 6/30/11 to 6/30/07**  
**Income Statement**  
**000,000's**

	Projected 6/30/2011	Actual 6/30/2010	Actual 6/30/2009	Actual 6/30/2008	Actual 6/30/2007
Revenues	\$ 1,127.5	\$ 1,058.1	\$ 944.7	\$ 849.6	\$ 836.3
Deductions	(816.3)	(765.2)	(692.1)	(618.1)	(623.9)
Other Revenue	22.5	25.0	22.3	18.9	22.7
Total Operating Revenue	<u>\$ 333.7</u>	<u>\$ 317.9</u>	<u>\$ 274.9</u>	<u>\$ 250.4</u>	<u>\$ 235.1</u>
Expenses:					
Labor Costs	\$ 208.2	\$ 198.6	\$ 172.9	\$ 157.4	\$ 152.0
Supplies	59.7	53.6	41.0	36.4	37.1
Other	45.9	45.3	44.1	44.6	46.5
Total Expense	<u>\$ 313.8</u>	<u>\$ 297.5</u>	<u>\$ 258.0</u>	<u>\$ 238.4</u>	<u>\$ 235.6</u>
EBITDA	19.9	20.4	16.9	12.0	(0.5)
Other Revenues	1.7	2.2	4.0	5.9	6.5
Depreciation & Interest	(18.1)	(18.0)	(16.4)	(19.8)	(17.6)
Operating Net Income	<u>\$ 3.5</u>	<u>\$ 4.6</u>	<u>\$ 4.5</u>	<u>\$ (1.9)</u>	<u>\$ (11.7)</u>
Non Operating Net Income	0	0	4.4	0	0
California Provider Tax Income	\$ 18.9				
Total Net Income	<u>\$ 22.4</u>	<u>\$ 4.6</u>	<u>\$ 8.9</u>	<u>\$ (1.9)</u>	<u>\$ (11.7)</u>
Return on Investment	6.71%	1.5%	3.2%	(.8%)	(5.0%)

# Antelope Valley Healthcare District



- Private Placement closed in late 2010
  - \$25MM at 4.82% due in 2021
  
- Bond Issue closed with three series
  - \$10 MM at 6.875% due 2026
  - \$3.62 MM at 7% due 2031
  - \$5.105 MM at 7.25% due 2036
  
- Bond Issue originally started as a BAB in October of 2011 but when it became evident the program was not being extended the structure was switched to tax-exempt bonds
  
- Bond Issue was closed during one of the most tumultuous times in recent history for municipal bonds

# Antelope Valley Healthcare District



## ■ Major Market Events During Bond Issuance Process

- November 2- Republican gains in Congress raise investor concerns that less federal aide would flow to states and cities
- November 3- Net weekly inflows into municipal bond funds fall to \$192,000, down from \$433 million the prior week
- November 11- S&P downgrades dozens of tobacco bonds to junk status forcing many municipal bond funds to sell lowering prices among many types of municipal bonds
- November 15- The State of California brings \$14 billion offering to the market
- November 17- Investors withdraw \$3.1 billion from municipal bond funds during the week, the start of a 13-week stretch of redemptions
- December 8- Tax deal in congress extending Bush tax-cuts does not include Build America Bond program extension
- December 19- Meredith Whitney appears on 60 Minutes and predicts 50-100 sizable municipal defaults totaling hundreds of billions of dollars
- January 19- Net outflows in municipal bond funds reached \$4 billion for the week
- February 9- Congressional hearing held where one of the topics was whether states could file for bankruptcy protection
- March 2- Nouriel Roubini, a prominent economist, predicts there could be \$100 billion in municipal defaults over the next 5 years

# Conclusion

- Affordable capital is **still available** for hospitals
- Look internally and externally to **identify all options**
- **Combining options** can customize debt
- Watch **federal legislation** for new/changed options
- **Multi-track** your financing to save time and maintain flexibility
- **Utilize** an investment bank that provides access to all options





# Thanks for Your Participation! Questions?

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