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Fewer Muni Bonds have Investors Snapping up Riskier Hospital Deals.

(Reuters) – A lean issuance calendar in the municipal bond market is propping up debt prices for U.S. cities and states and will likely keep a floor under some of the market's wobbly sectors, even hospitals, according to data and analysts.

The scarcity of new deals also provides an opportunity for less credit worthy municipal issuers to come to market when cash levels are high and demand is strong.

Credit traditionally seen as more risky by investors, such as BBB-rated hospitals that rely heavily on government-funded Medicaid and Medicare, are seeing "enthusiastic demand" from the market, said Alan Schankel, municipal strategist at Philadelphia-based Janney Montgomery Scott.

But sweeping changes to the country's healthcare law currently under consideration by Congress has woven uncertainty into hospitals' future revenue streams. Such a tumultuous environment should give caution to investors to beware of debt tied to healthcare, in particular city and safety net hospitals.

"It certainly flashes a yellow light for me, a caution light," said Schankel. But when it comes to new bond issues coming to market, "there is nothing around, so investors are chasing this stuff."

Demand for bond deals will likely surge even more this summer, as billions of dollars worth of municipal bonds exit the market.

"The supply is way down. You have far fewer bonds in the market," said Greg Saulnier, municipal research analyst at Thomson Reuters' MMD. "With so much money and cash pouring back into the market, you have guys flush with cash with no where to put it."

Some $130 billion to $140 billion in bond redemptions will outweigh the $100 billion of new debt expected to be issued in June, July, and August. The extra cash will likely set records, municipal analysts say, driving demand and bond prices up because of a dearth of deals in which investors can participate.

The "wave of cash" will create a "steady if not strong performance for the marketplace going into the end of summer," said Jim Colby, portfolio manager for VanEck's municipal bond investments. "You can see why this is an interesting time."

HEALTHY DEMAND

Demand for hospital credits comes at a time of huge uncertainty and potential upheaval for the healthcare sector. U.S. President Donald Trump and the Republican-led Congress have vowed to repeal and replace the Affordable Care Act, the nation's healthcare law commonly referred to as Obamacare.

A Republican-proposed healthcare bill approved by the House and now under consideration by the Senate would likely reduce federal Medicaid payments to states, a large revenue source for hospitals.

“We have seen incremental rating pressure recently, even among some of our largest and strongest organizations,” said Martin Arrick, managing director at S&P Global Ratings. “This pressure could grow, and threaten our stable outlook on the sector, depending on administrative and legislative actions under the new administration,” Arrick said.

Tax-exempt 10-year BBB-healthcare bonds on Friday saw a 2.97 percent yield and a 111 basis point spread over the benchmark MMD AAA yield curve. That spread has remained the same since the end of last year, even as the sector’s yield has declined from 3.42 percent on Dec. 30th.

Recent examples of the lower rated healthcare sector bonds hitting some high notes include two California hospitals from the BBB-rated category – Children’s Hospital Los Angeles sold $275 million and Eisenhower Medical Center in Southern California’s Coachella Valley sold $233 million. Both deals, done in May, saw yields reduced after preliminary pricing by 5 to 15 basis points, evidence of stronger-than-expected investor demand.

Cleveland’s MetroHealth sold $946 million of revenue bonds in May, even after the system received a three-notch downgrade from all three rating agencies.

The bonds saw strong after-market activity, topping the list of most active issues.

One tranche of the 40-year maturity carrying a 5 percent coupon was initially priced at a slight discount of 99.48, and a 5.03 percent yield. Nearing the end of the day’s activity, however, block trade yields fell as low as 4.64 percent, lifting the price to 102.78, according to Schankel. MetroHealth reported that 122 banks, firms, and individuals competed for the bonds.

“I don’t know that it’s quite in the category of frothiness, but it’s getting close,” Schankel said.

Reuters

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