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U.S. Hospitals, Schools Rush to Raise Tax-Free Funds.

Borrowers raised more than $4 billion in private-activity bonds last week, even as Congress debates doing away with tax exemptions for such debt

Hospitals, universities and nursing homes across the U.S. are rushing to borrow money tax-free—while they still can.

Last week, borrowers issued more than $4 billion in new so-called private-activity bonds, which allow nonprofits and some for-profit firms to raise money for development projects perceived to have a public benefit.

That was triple the amount issued during the same week in 2016, according to a Municipal Market Analytics analysis of Bloomberg data, and one of the highest weekly issuances of the past two years. Prices on private-activity bonds have increased this week alongside other municipal bonds.

The borrowing outbreak is happening as Congress debates whether to do away with long-held tax exemptions on these bonds beginning Jan. 1. A House bill would eliminate the benefit altogether, while a bill that passed the Senate would leave the bonds untouched.

The Senate and House are working to send President Trump an agreed-upon version by Christmas. House Ways and Means Committee Chairman Rep. Kevin Brady (R., Texas), the lead negotiator from the House, this week suggested he might favor limits.

“I’m convinced their mission has drifted quite a bit,” he said. “They should be focused on infrastructure projects that help build and enhance the national infrastructure because they’re receiving national subsidies from every taxpayer in America.”

Private-activity bonds allow nonprofits and some for-profit firms to do what state and local governments do: borrow money at cheaper rates. Investors don’t demand as much interest because they don’t have to pay taxes on their earnings.

Their name refers to their use: proceeds pay for a variety of projects that benefit private entities like charter schools, museums, private universities, hospitals and nursing homes. Proceeds have averaged about $110 billion annually over the past decade.

Many borrowers and investors are not waiting to see what happens in Washington. Bond buyers last week rushed to purchase private-activity bonds for a railroad planned along Florida’s coast, putting in bids for approximately $2 billion worth of bonds even though only $600 million were for sale, according to Wes Edens, Chairman of Fortress Investment Group, which is leading construction of the project. The issuer was the Florida Development Finance Corporation.

“Pricing was probably a little bit better than we thought it would be,” Mr. Edens said.

One borrower in North Dakota decided to seek buyers for $363 million in bonds three weeks earlier than planned. The proceeds would help pay for a new Trinity Health hospital and replace two buildings constructed about 100 years ago. Preliminary documents were filed Tuesday to avoid the risk of being shut out of the tax-exempt markets, said Dennis Empey, chief financial officer for Trinity Health.

Another hospital operator, Mercy Health in Cincinnati, Ohio, also rushed a planned $585 million issuance to market while the congressional tax debate unfolded, said Jerome Judd, Mercy's senior vice president of treasury and investment. The system, which operates 23 hospitals in Ohio and Kentucky, said the bonds are expected to be priced next week instead of the first quarter next year.

Loss of access to tax-exempt financing would raise Mercy's borrowing costs, leaving less money for capital investments and community outreach, Mr. Judd said. The planned financing will be used for outpatient investment and refinancing existing debt, he said.

Congress first established rules for these bonds in 1968, offering a specific list of approved projects including airports and low-income housing. In the 1980s, Congress added new types of private-activity bonds and capped how much nonprofits could issue, but that cap was lifted in the 1990s.

Some critics of the bonds have argued certain borrowers shouldn't be able to benefit from the exemption. A Congressional Budget Office report in December found that some projects financed with private-activity bonds "probably would take place without a subsidy" and others likely would not be worth the cost.

Hospitals, universities, engineers, airports, bond lawyers and public officials have argued that ending the tax exemption for these bonds would make it more difficult to complete vital projects.

Many of the bonds currently offer relatively high yields in an otherwise sedate, low-rate market because borrowers who lack taxing power to back their bonds often pay higher interest rates. Those who follow the market are predicting it will shrink if the exemption is gone.

"If private activity issuance ends, a high amount of high yield muni issuance could go away," said Jamie Iselin, head of municipal securities at investment manager Neuberger Berman.

At the City National Rochdale Municipal High-Income Fund, which manages $1.2 billion in high-yield municipal debt, senior portfolio manager Bill Black estimated that about two-thirds of his portfolio is made up of private-activity bonds.

"If the House tax bill gets approved it'll be hard for us to find bonds going forward," Mr. Black said. High-yield muni funds have suffered challenges in recent years as a result of limited issuance of tobacco bonds—high-yield bonds backed by payments from state settlements with tobacco companies.

High-yield bonds have rallied in recent weeks, pushing the S&P Municipal Bond High Yield Index to its highest point since the quarter began Oct. 1.

Even without a change in tax policy, private-activity bonds will likely become scarce and valuable in the next quarter, since many of the deals planned for January and February of next year are instead getting done in December. Demand tends to increase somewhat in January, when a large portion of bonds come due, leaving bondholders with cash to reinvest. Many bond investors are using this month's increase in supply as an opportunity to stock up.

Moody's Investors Service has been asked to issue credit ratings for roughly $8 billion in nonprofit health-care bonds this month, said Brad Spielman, a Moody's analyst for the sector.

“This may very well be the biggest month of issuance since 2008,” Mr. Spielman said.

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