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Hospital Munis' Record Rally at Risk as Health Law Goes to Court.

As the fate of President Barack Obama's signature health-care law awaits a Supreme Court ruling, an unprecedented winning streak by hospital debt hangs in the balance.

Municipal bonds sold by hospitals have earned 0.9 percent this year, while the $3.6 trillion municipal market as a whole has lost 0.1 percent amid a broad fixed-income selloff, Bank of America Merrill Lynch data show. The securities are beating the market again in June, prolonging a record 15 months of outperformance. Hospitals have drawn buyers with a combination of higher yields and bolstered balance sheets as the Affordable Care Act covers millions more Americans seeking treatment.

The legal decision, likely in the next two weeks, may upend the rally by ending federal premium subsidies in states that didn't set up exchanges for buying insurance. That result would pose a risk to not-for-profit hospitals, which have increased operating margins as more patients show up with insurance, according to Moody's Investors Service.

With a ruling against the health law, "you have to imagine that will create some volatility and uncertainty as it relates to anything health-care related," said James Iselin, head of munis in New York at Neuberger Berman, which oversees about $10 billion of munis, including hospital bonds.

Medicaid Expansion

The suit, King v. Burwell, challenges the availability of tax credits to discount the cost of insurance in at least 34 states. Opponents say the law allows subsidies only in the 16 states that created insurance marketplaces. Three years ago, the court upheld the core of Obama's health-care overhaul.

The 2010 law has strengthened some hospitals' finances by cutting their unpaid bills in the states that expanded Medicaid to the poor as part of the law's introduction, according to Moody's. Twenty states have refused to expand Medicaid, though two are considering it, according to the Kaiser Family Foundation in Menlo Park, California.

Rockcastle Regional Hospital & Respiratory Care Center in Mount Vernon, Kentucky, shows the financial gains from changes in health-care and the appeal of high-yielding hospital debt to investors.

'Sky High'

The facility sold $7.2 million of bonds last month to pay for expansion. The hospital, in a state that expanded Medicaid and has its own insurance exchange, has benefited from the flow of newly insured patients, according to Jana Bray, a spokeswoman.

"The number of uninsured we had here was sky high," Bray said. "People are actually coming to get care now because they can.”

Rockcastle Regional issued unrated bonds maturing in June 2030 that priced to yield 4.25 percent, data compiled by Bloomberg show. That was about 1.6 percentage points more than AAA munis. By comparison, benchmark BBB revenue bonds with a similar maturity yielded 3.75 percent.

Snoqualmie Valley Hospital, near Seattle, has a similar story. It plans to borrow as much as $82 million next week and expects to draw investors because Medicaid coverage has increased while it sees fewer uninsured patients, Chief Executive Officer Rodger McCollum said. Other changes from the law have helped fill rehabilitation beds, he said.

Borrowing Increase

Moody’s raised the ratings of more health-care issuers than it lowered in the last quarter of 2014. For the first time since 2011, not-for-profit hospitals saw revenue grow faster than expenses, the credit rater said.

As a result of stabilizing margins, hospitals have borrowed about $14 billion through the municipal market this year, the fastest pace since 2012, data compiled by Bloomberg show.

“Hospitals have been trying to tighten their expenses, and now they’re spending some of the extra cash flow they’re generating,” Daniel Steingart, a Moody’s analyst, said in an interview.

That could change with a decision against Affordable Care Act subsidies. The ruling would drive up uncompensated care costs as more people give up coverage they can no longer afford, undoing some of the systems’ gains from an improving economy and reduced expenses, according to Moody’s.

“It’s clearly going to be negative: Even on the margin, people will lose insurance coverage,” Steingart said. “There’s no other way to spin it.”

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