Bond Case Briefs

Municipal Finance Law Since 1971

Loss of Tax-Exempts Would Widen the Gap Among Healthcare Issuers.

CHICAGO — Already bruised this year by GOP efforts to dismantle the Affordable Care Act and pressured on operations, the not-for-profit healthcare sector would also face higher capital costs should the House Republican tax bill pass.

The package before the House would eliminate tax-exempt advance refundings and private activity bonds for housing, private universities, not-for-profit hospitals, and other development projects. The Senate Republican proposal preserves PABs. Leaders are aiming for reconciliation between the two in mid-December.

The end of tax-exempt borrowing would ripple through the hospital sector with far-reaching effects across the healthcare landscape, said market participants.

It could drive more interest in direct bank loans and prompt an even bigger wave of mergers and consolidations as smaller and lower-rated hospitals and systems struggle to raise affordable capital. The current consolidation wave has largely been driven by hospital efforts to conform to changes demanded by the ACA.

“I think certainly it’s going to be difficult for hospitals and it’s going to raise capital costs, but for the larger and highly-rated systems they will probably be O.K. because they have been issuing some taxable debt and have relationships and there are cross-over buyers that are certainly interested,” said George Huang, a director in Municipal Securities Research at Wells Fargo Securities. “They are sophisticated and can spread the additional costs.”

“Where it becomes more of an issue is for the smaller guys who will see their market access impaired,” Huang added. “The whole municipal market would evolve.”

On Tuesday, GOP senators announced their version would include a repeal of the ACA’s individual insurance mandate in a move to help cover the deficit from tax cuts. The Congressional Budget Office has estimated that 13 million would lose coverage without the mandate.

That could drive up the uncompensated care costs for hospitals that fell after the ACA was adopted and the ranks of insured – either through private insurance or Medicaid expansion — swelled.

Healthcare borrowers have brought $32.7 billion of tax-exempt issuance to market so far this year, according to data from Thomson Reuters (TRI). About $300 billion of long-term, tax-exempt healthcare-related borrowing and about $20 billion of short-term paper was outstanding last year, said Richard Ciccarone, president of Merritt Research Services.

Smaller hospitals likely would rely more on bank loans which could grow more costly as their deals are often too small and not index eligible to attract traditional fixed-income corporate buyers, said one public finance healthcare banker whose clients include both small, local systems and national systems.

“If a corporate buyer has a choice between a known name and larger, double-A rated system and a smaller A rated system or hospital that requires more research, they are going to pick the known name,” said the healthcare banker.

The banker said there could possibly be some accommodation in the corporate market in response to the tax changes, with a sub-sector focused on paper from former tax-exempt borrowers. Still, using the corporate market requires a whole new set of demands on borrowers; make-whole call features are preferred to traditional 10-year municipal calls and more frequent routine disclosure is required which can add to a borrower’s cost, the banker added.

Nuveen offered a similar assessment on the disparity.

“For issuers, we expect a bifurcated outcome: larger, more highly rated issuers should be able to access the taxable bond market for their infrastructure financing needs. Smaller, lower-rated or non-rated issuers may be unable to access the bond market,” Shawn O’Leary, senior vice president at Nuveen Asset Management LLC, said in a report on the impact of the tax bill on various sectors.

The average spread between the Bloomberg Barclays Taxable Municipal Bond Index and the Bloomberg Barclays Municipal Bond Index from November 2016 through October was 126 basis points. The higher costs could force some to put off projects or renovations.

“Demand exists in the tax-exempt market for these smaller deals, and professional investors have the credit research capabilities to analyze such issuers,” O’Leary said. “This is not true of the taxable market. The loss of access to the tax-exempt market would likely shut out critical access hospitals.”

Huang added that the full extent of the hit might not be felt until rates rise or spreads widen between taxable and tax-exempts. “For years, hospitals have had excellent cost of capital and could borrow cheaply,” he said.

Some upsides exist on the use of taxable debt and that’s been the appeal for larger systems. It frees them of the burden of going through a conduit issuer, so they can get into the market more quickly, and it frees them from IRS rules on how the proceeds can be spent. “For some, it’s worth the tradeoff,” Huang said.

Another upside is for current holders. The elimination of advance refunding could drive up demand for existing tax-exempt healthcare paper, improving its valuation, Huang said.

The American Hospital Association sounded the alarm on behalf of its members in a letter last week to the House Ways and Means Committee, warning that smaller hospitals can’t afford more costly loans and taxable borrowing, saying that throughout the sector the higher costs will be borne by patients.

“Non-profit hospital borrowers save, on average, an estimated two percentage points on their borrowing compared to taxable bonds or bank financing,” wrote Thomas Nickels, AHA executive vice president.

“Lower borrowing costs translate into lower health care costs for patients. The lower cost of tax-exempt financing also makes possible necessary upgrades and modernizations that would not be possible for hospitals with weaker finances,” he added.

In the near-term, conduits could see a rush to market. It’s a tough task to hurry a deal to market if not already in the works. The deal must run through the conduit process which includes a TEFRA

hearing required by the Internal Revenue Service and counsel must issue an opinion. For issuers that had plans for early 2018 financings, it's doable, and slated deals can be increased.

Michigan-based Trinity Health is speeding up planned borrowing that would include $200 million of net new money, up to $300 million to reimburse itself for a hospital acquisition, and a refunding of up to $550 million.

"We are looking at trying to come to market at some time in December," Dina Richard, treasury and chief investment officer, said during the system's annual investor call last week. "We have accelerated our plan of finance in light of the recent tax reform discussion," she said.

"The Illinois Finance Authority would be accommodating, and is prepared to speed deals through the hearing process and would call special meetings if any borrower has any needs that arise" until Dec. 31, said its executive director, Christopher Meister.

The agency is the state's primary route for healthcare borrowers to access the municipal market. A financing on the board's agenda last week for Northwestern Memorial Healthcare was increased in size slightly due to the change.

Higher borrowing costs would exacerbate existing fiscal pressures due to changes in customer demands, cost consciousness and public and congressional pressure to contain costs along with changing reimbursements with a wave of retirements among Baby Boomers, market participants added.

Fitch Ratings left a negative outlook on the sector this year while the rating outlook is stable. Pressures on operating margins reflect the erosion in payor mixes as the baby boom generation moves into Medicare and newly eligible Medicaid patients access more healthcare services to address deferred care and chronic conditions. The sector also faces growing wage and benefit pressures.

BY SOURCEMEDIA | MUNICIPAL | 11/15/17 07:20 PM EST

By Yvette Shields

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com