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Accessing Capital In the New Normal

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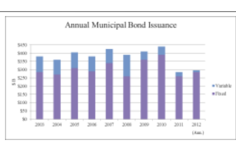
Becker's Hospital Review

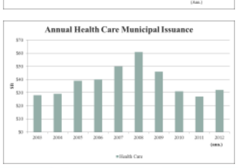
Offering Financial Advice and Solutions to Health Care, Senior Living, and Housing Providers.

TOPICS

- Healthcare Issuance
- Credit Ratings
- Private Sector Funding Options
- Agency Funding Alternatives
- Case Studies
- Funding Summary & Best Practices

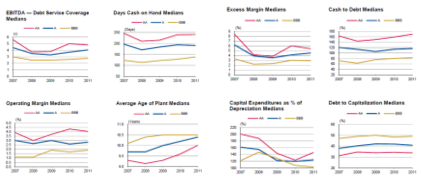
HEALTHCARE MUNI VOLUME





- Overall muni issuance has rebounded to historical averages
- The majority of municipal debt since 2010 has been issued as fixed rate
- Health Care municipal issuance has seen a steep decline since the peak of 2005 – 2007 and the massive restructurings in 2008
- Lower volume has actually increased demand from investors, depressing yields for borrowers

FITCH 2012 MEDIAN RATIOS



- Stable Profitability Metrics – IG credits consistent with prior year, but speculative credits down
- Stable Liquidity – In line with prior year; up from 2008 lows
- Improved Debt Service Coverage – IG median up from 3.5x to 3.8x
- Ongoing Capital Investment – Consistent with prior year, but below 150% of depreciation prior to 2009
- Weakened Performance for Speculative Credits – Credit gap to continue to widen
- Downgrades Continue to Outpace Upgrades – Majority of downgrades at BBB or non IG levels
- Continued Uncertainty in Healthcare – Uncertainly regarding reimbursement levels over medium term

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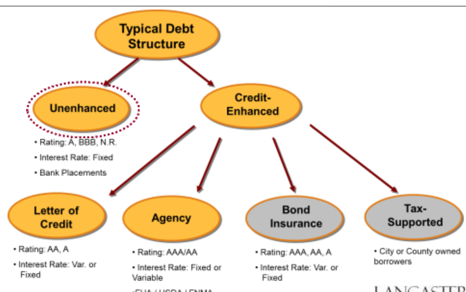
DEBT FUNDING OPTIONS



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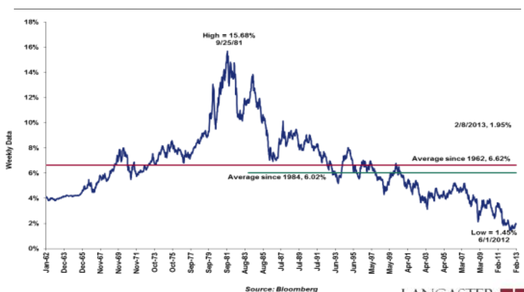
10-YEAR TREASURY YIELD



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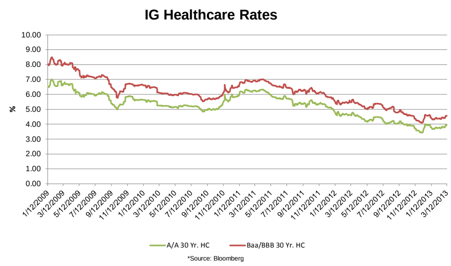
HISTORICAL HEALTHCARE RATES



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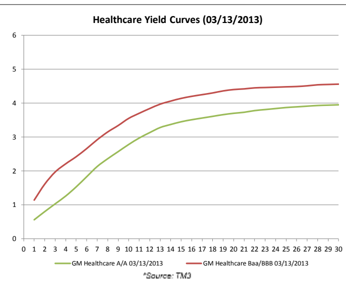
CURRENT HEALTHCARE YIELDS



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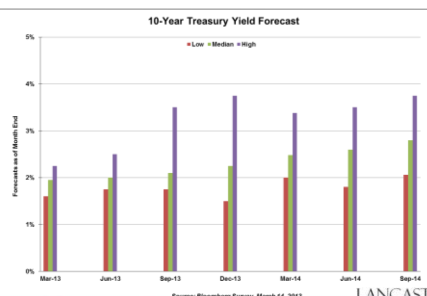
10-YR TREASURY FORECAST



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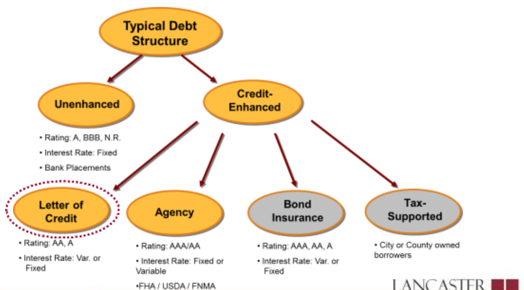
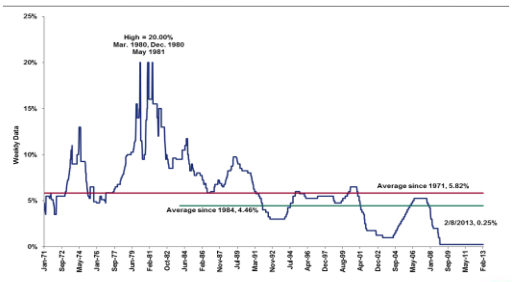
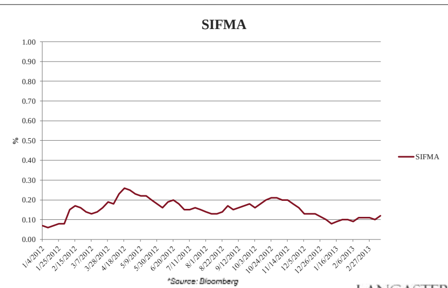
DEBT FUNDING OPTIONS



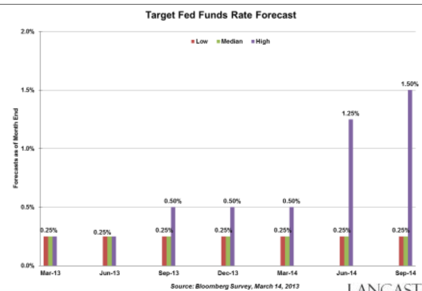
TARGET FED FUNDS RATE



HISTORICAL TAX-EXEMPT VARIABLE RATES



FED FUNDS FORECAST



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OUTLOOK: TARGET FED FUNDS RATE

- **The Fed would likely need some combination of the following before raising interest rates:**
  - Faster economic growth = 3-4%
  - Lower unemployment = 6-7%
  - Stable PCE inflation = 2%
- **Despite positive recent trends, none of these three measures have shown significant improvement**

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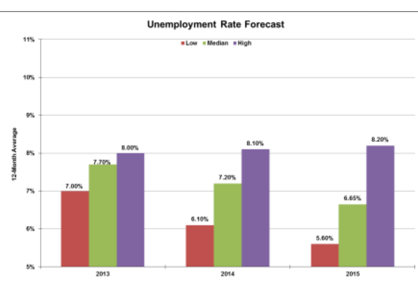
UNEMPLOYMENT FORECAST



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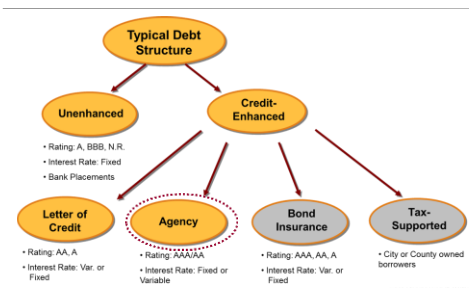
SHRINKING LOC SUPPLY
BASEL III CAPITAL REQUIREMENTS

- **New global standards for bank capital adequacy and liquidity**
  - Agreed upon by Basel Committee on Banking Supervision
  - Capital Req., Leverage, and Liquidity standards implemented over the next 5 years (through 2018)
- **New Capital Requirements component decreases a bank's willingness to provide LOCs**
  - Basel III = higher reserve requirements for LOCs

PRIVATE PLACEMENT

- **Similar net pricing and terms to LOC enhanced bonds (VRDBs)**
- **Variable or fixed**
- **Eliminates banks' contingent liquidity risk**
- **Enable community and regional banks to compete with "a1/P1" banks (super-regional and national banks)**
- **Bank qualified or non bank qualified**

DEBT FUNDING OPTIONS



FHA 242

- Construction & Permanent Financing
- Rate currently below 5% fixed
- 25 year term & amortization (begins after construction completion)
- No bank financial covenants
- No renewal / refinance risk
- Eliminates negative arbitrage
- Eliminates DSRF (although MRF required to be built over 10 years)
- High LTV (90% LTV; net PPE contributed as equity)
- Assumable loan
- Additional indebtedness funding via FHA 241 funding
- Longer timing (6-8 months; compared with approx. 4 months for private sector financing)
- FHA 242f refinance option now available

USDA CF

- Direct Loan
  - $1.3B national allocation in FY 2012
  - 3.125% fixed
  - 40 year term/amortization
- Guaranteed loan
  - 90% guarantee
  - Variable or fixed
  - Up to 30 year term/amortization
- Provides for parity indebtedness

CASE STUDY #1 – SAUK PRAIRIE MEMORIAL

- Independent hospital
- Non-Profit / Non-Government
- 36 inpatient beds
- Prairie du Sac, WI
- Replacement hospital
- $69M project amount

SAUK PRAIRIE MEMORIAL
HOSPITAL & CLINICS
Extraordinary healthcare from the heart — one person at a time

HISTORICAL RATIO ANALYSIS

Sauk Prairie Memorial Hospital	Audit FYE 2009	Audit FYE 2010	Internal YTD 2011	Fitch 2011 Medians "BBB"	Fitch 2011 Medians "A"	S&P 2011 Medians "BBB"	S&P 2011 Medians "A"	YTD 2011 Fitch Comparison
Profitability Ratios								
Operating Margin (%)	7.0	9.4	6.3	1.1	2.5	1.6	2.8	A
Excess/Profit Margin (%)	11.1	12.2	7.0	2.0	4.1	3.0	4.6	A
Cash Flow (EBITDA) Margin (%)	15.1	15.7	10.8	9.1	10.3	9.7	12.1	A
Liquidity Ratios								
Days Cash on Hand Ratio	201.0	226.0	245.4	123.3	191.3	133.6	201.9	A
Cushion Ratio	18.7	11.4	6250.9	7.9	17.9	9.6	17.7	A
Cash to Debt (%)	1,997	34,076	N/A	89.8	159.5	97.0	145.2	A
Days in Accounts Receivable	38.4	34.1	35.0	45.3	43.6	44.7	44.2	A
Capital Structure Ratios								
Historical DSC Ratio (EBITDA)	6.2	3.5	1131.1	2.2	3.3	2.9	4.2	A
Debt to Capitalization	2.6	0.2	0.0	44.9	35.6	41.0	32.6	A
Average Age of Plant (years)	11.7	12.7	13.0	11.0	10.8	10.2	9.9	Not I.G.

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PROFORMA RATIO ANALYSIS (RFP)

Sauk Prairie Memorial Hospital	Projected 2015	Fitch 2011 Medians "BBB"	Fitch 2011 Medians "A"	S&P 2011 Medians "BBB"	S&P 2011 Medians "A"	2015 Proj. Fitch Comparison
Profitability Ratios						
Operating Margin (%)	-0.9	1.1	2.5	1.6	2.8	Not I.G.
Excess/Profit Margin (%)	1.8	2.0	4.1	3.0	4.6	BBB
Cash Flow (EBITDA) Margin (%)	14.4	9.1	10.3	9.7	12.1	A
Liquidity Ratios						
Days Cash on Hand Ratio	164.7	123.3	191.3	133.6	201.9	BBB
Cushion Ratio	5.8	7.9	17.9	9.6	17.7	Not I.G.
Cash to Debt (%)	45.4	89.8	159.5	97.0	145.2	Not I.G.
Days in Accounts Receivable	37.0	45.3	43.6	44.7	44.2	A
Capital Structure Ratios						
Historical DSC Ratio (EBITDA)	2.0	2.2	3.3	2.9	4.2	BBB
Debt to Capitalization	51.9	44.9	35.6	41.0	32.6	Not I.G.
Average Age of Plant (years)	4.8	11.0	10.8	10.2	9.9	A

**RFP assumed $77.3MM project cost; $64.2MM debt + $11.4MM equity + $1.7MM investment income*

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STRUCTURE SUMMARY

- **Tax-Exempt Revenue Bond via WHEFA**
- **Par Amount: $68MM**
- **Term: 35 Years (2048 maturity)**
- **TIC: 4.39% (4.52% All-in TIC)**
- **MADS: $4.1MM**
- **Equity: $8.3MM**
  - DSRF A: $3.4MM
  - DSRF B: $2.0MM

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OFFERING BREAKDOWN – SERIES A

- **Unenhanced Rated Fixed Rate**
- **Par Amount: $38MM**
- **Term: 35-yr term**
- **Amortization: 35-yr term**
- **TIC: 5.32% (5.4% All-in TIC)**
  - 25 Yr. Term @ 5.125%
  - 30 Yr. Term @ 5.250%
  - 35 Yr. Term @ 5.375%
- **10-year hard lock followed by prepay at par**
- **Buyers: 5 funds**

OFFERING BREAKDOWN – SERIES B

- **Bank Purchase Variable Rate**
- **Par Amount: $30MM**
- **Term: 10-yr term**
- **Amortization: 17-yr am**
- **TIC: 2.10% (2.36% All-in TIC)**
- **No prepay lockout**
- **Bank Group:**
  - First Merit (Akron, OH) ($15.0MM)
  - Bank of Prairie du Sac (Prairie du Sac, WI) ($5.0MM)
  - Wisconsin River Bank (Prairie du Sac, WI) ($1.6MM)
  - River Bank (La Crosse, WI) ($8.4MM)

SAUK PRAIRIE MEMORIAL UPGRADE

CASE STUDY #2 – CAMERON MEMORIAL

- Critical Access Hospital
- Non-Profit / Non-Government
- 25 inpatient beds
- Angola, IN
- Replacement hospital
- $43M project amount

CREDIT PROFILE

- Rust-belt, auto-heavy market area
- Investment grade liquidity and capital structure ratios
- Threshold investment grade profitability rations (volatility)
- Proforma balance sheet extremely leveraged with significantly non investment grade cash to debt position
- Proforma debt service coverage near 2x with CAH capital cost reimbursement
- Phased project (approx 3 years)

2009 “BRIDGE” BOND STRUCTURE

- Bank Qualified Tax-Exempt Private Placement with bank syndicate
- Blended Fixed Rate: 3.14%
- Term = 3 Years
- Amortization = 25 Years
- Prepayment Provisions = None

2009 DEBT SERVICE SAVINGS *(ACTUAL)*

	Existing Debt	New Debt
Principal	$8.1MM	$14.765MM
Interest Rate	4.75% - 5.00%	3.14%
Annual Debt Service	$1,043,000	$853,129

- **Decrease annual debt service by approx. $200K**
- **Preserve and build liquidity**
- **Flexibility w/r/t new debt offering (no prepay provisions)**

MAJOR FUNDING SUMMARY

- **Hospital project funded through a USDA-based financing structure**
- **USDA CF direct ($37M) and guaranteed ($10M) loans will provide permanent debt funding**
  - $1M of guaranteed funding is provided by guaranteed lender (Farmers & Merchants)
- **Construction financing is provided by Bond Anticipation Notes ($37M), F&M ($10M) and Hospital equity ($6M)**

CAMERON MEMORIAL UPGRADE




FUNDING SUMMARY & BEST PRACTICES

- Affordable capital is available to 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*

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QUESTIONS?

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STEVEN W. KENNEDY JR.

Steven W. Kennedy, Jr., is Lancaster Pollard's lead investment banker in Illinois and Wisconsin, as well as one of the firm's regional managers, overseeing investment banking operations in several states throughout the Midwest.

Since joining Lancaster Pollard in 2001, Mr. Kennedy has been instrumental in bringing to market a variety of financing structures totaling over $1 billion. He was named the firm's Top Health Care Banker in recent years, and structured and underwrote the firm's "Deal of the Year" in 2010. Mr. Kennedy gained national recognition in 2008 when he structured and closed the country's first tax-exempt, non-housing bond backed by the Federal Home Loan Bank. Prior to joining Lancaster Pollard, Mr. Kennedy worked for U.S. Sen. Richard G. Lugar (Indiana) in Washington D.C.

Mr. Kennedy earned his MBA from the Fisher College of Business at The Ohio State University in Columbus, Ohio. He received a bachelors degree (magna cum laude) in economics and political science and a certificate in organizational studies from Denison University in Granville, Ohio. He holds General Securities Representative (Series 7) and General Securities Principal (Series 24) licenses, and is a frequent speaker and author on capital funding for health care providers.

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