

Low Cost Capital: New Money and Refinancing

In an age of Federal Reserve Intervention

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Proposition

The current low rates in both the taxable and tax-exempt markets has been an ideal time to do long-term fixed rate taxable debt.

Corporate America is borrowing at unprecedented levels for as long as they can.

Pressure is mounting on not-for-profit hospitals to loose or limit their access to historically low cost tax-exempt debt.

Is the canary in the mine telling us something important about the capital markets and healthcare provider access?



Topics

- Federal Reserve interest rate suppression
- Compression between taxable and tax-exempt interest rates
- Differences in accessing the taxable and tax-exempt markets
- Case studies of how hospitals have leveraged market access through the use of HUD mortgage insurance
- Understanding how the newest HUD hospital insurance product, 223(f) refinancing can work for you



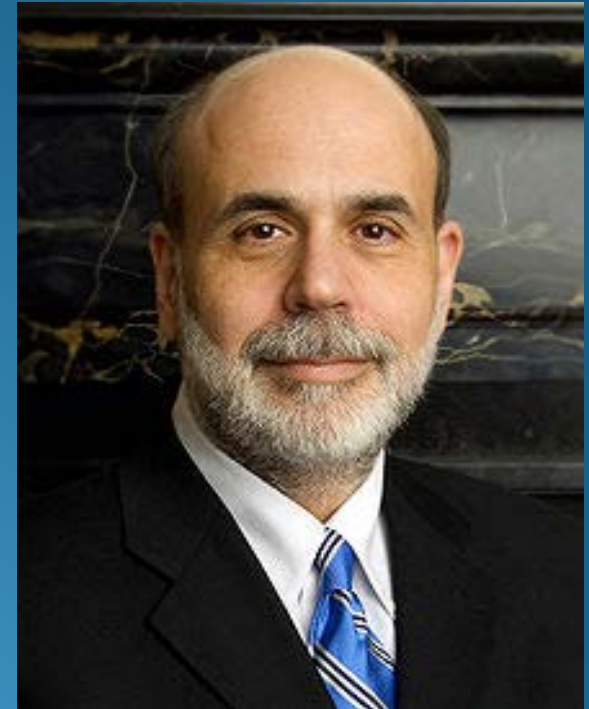
Federal Reserve interest rate suppression

Long-Term Interest Rates

Ben Bernanke:

“Long-term interest rates in the major industrial countries are low for good reason: Inflation is low and stable and, given expectations of weak growth, expected real short rates are low. Premature rate increases would carry a high risk of short-circuiting the recovery, possibly leading – ironically enough – to an even longer period of low long-term rates. Only a strong economy can deliver persistently high real returns to savers and investors, and the economies of the major industrial countries are still in the recovery phase.”

March 1, 2013



Theoretical components of Long-Term Interest rates

- **Inflation:**
Expected inflation over the term of the security
- **Short-Term rates:**
The expected path of short-term, inflation adjusted interest rates
- **Term Premium :**
The extra return investors expect to obtain from holding long-term bonds as opposed to holding and rolling over a sequence of short-term securities over the same period.

Theoretical components of the 10 year treasury rate

Chart 2. Decomposition of 10-Year Treasury Yield



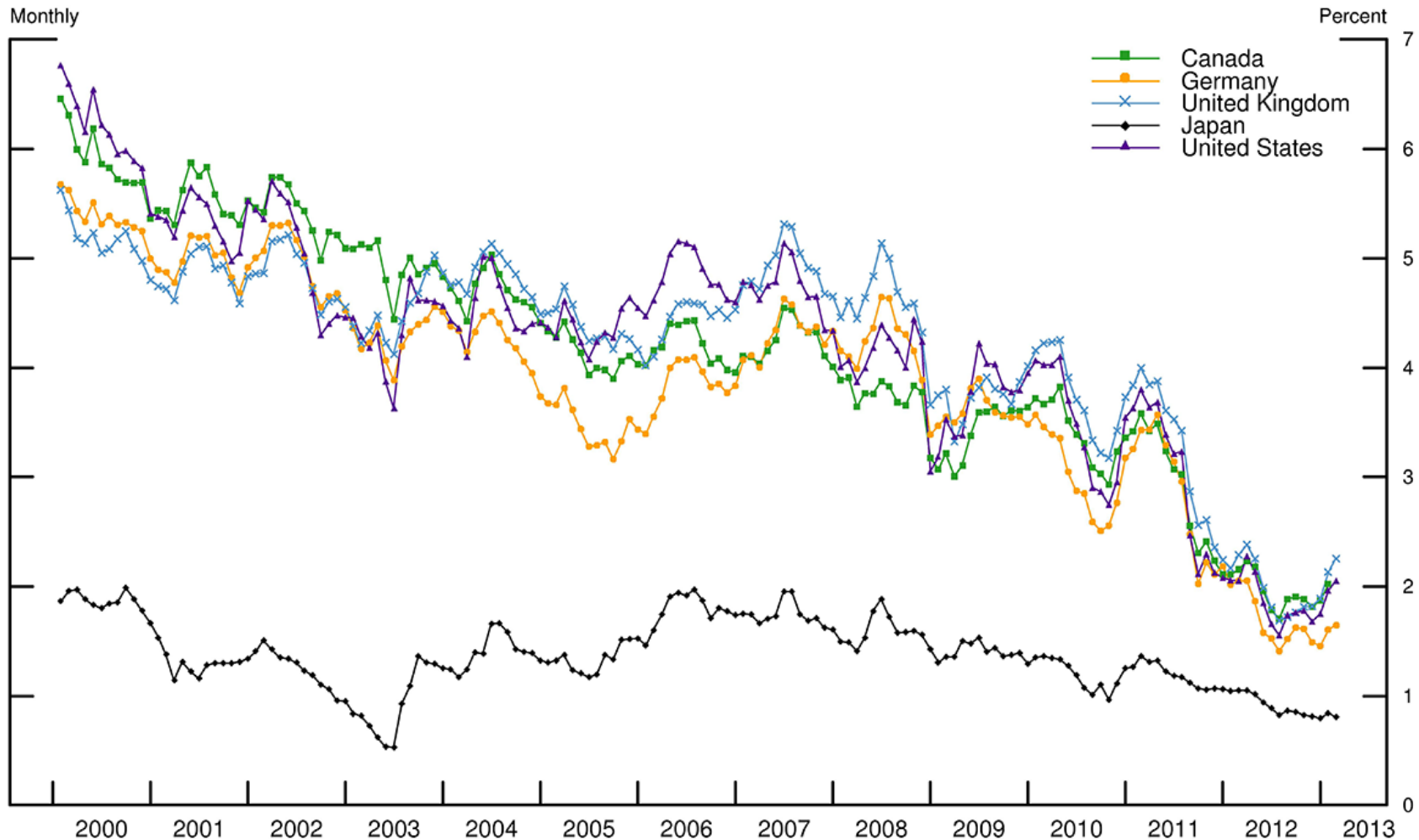
Note: Decomposition of 10-year zero-coupon Treasury yield based on the term structure model of D'Amico, Kim, and Wei (2010).

Source: Federal Reserve Board; Barclays PLC; staff calculations.

Worldwide interest rates are forecast to continue to decline

Chart 1. 10-Year Government Bond: Nominal Yield

Monthly

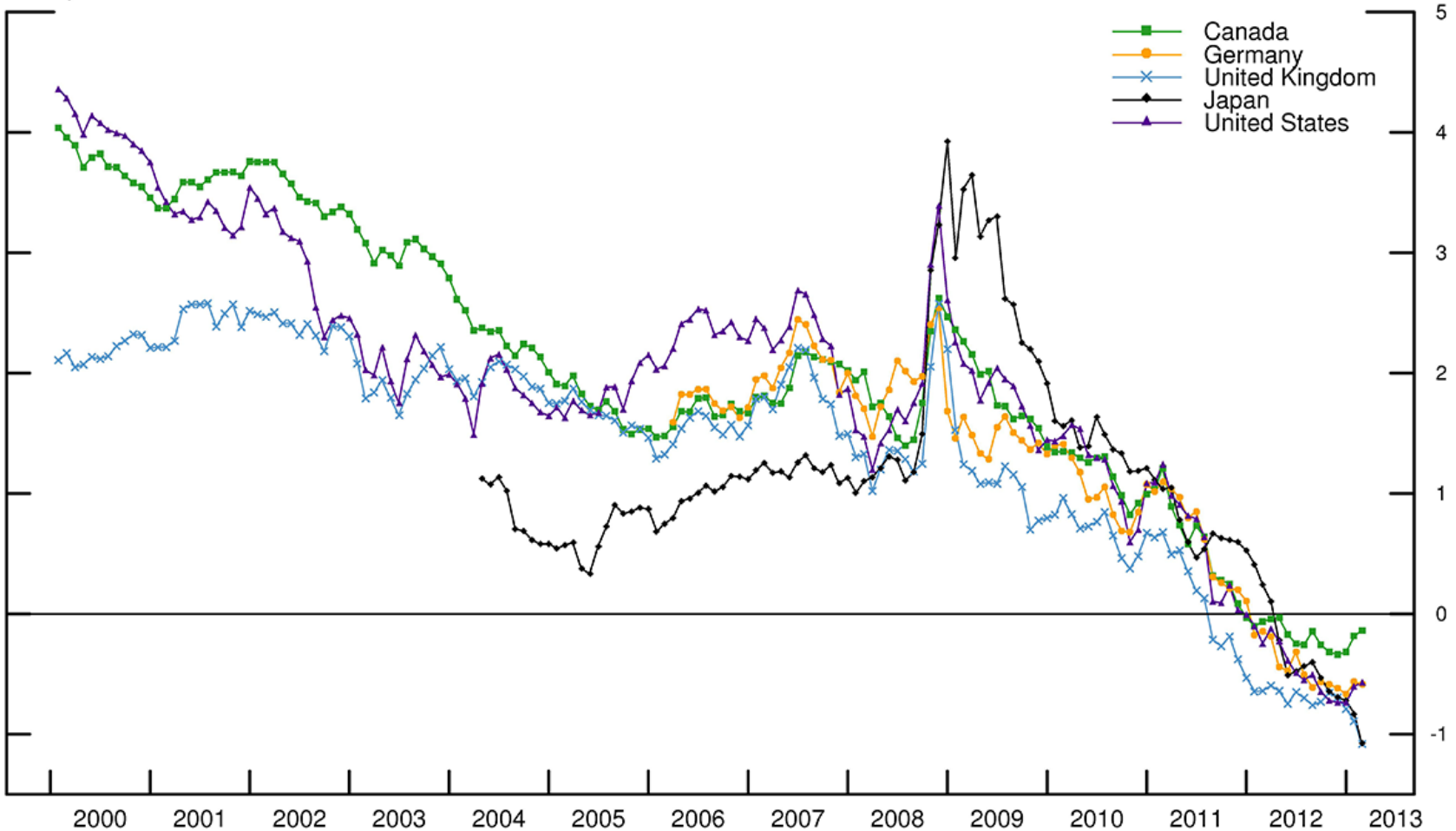


Note: 10-year zero-coupon sovereign bond yields.
Source: Federal Reserve Board staff estimates.

Inflation indexed Government Bonds

Chart 3. Inflation-Indexed Government Bond Yield

Monthly



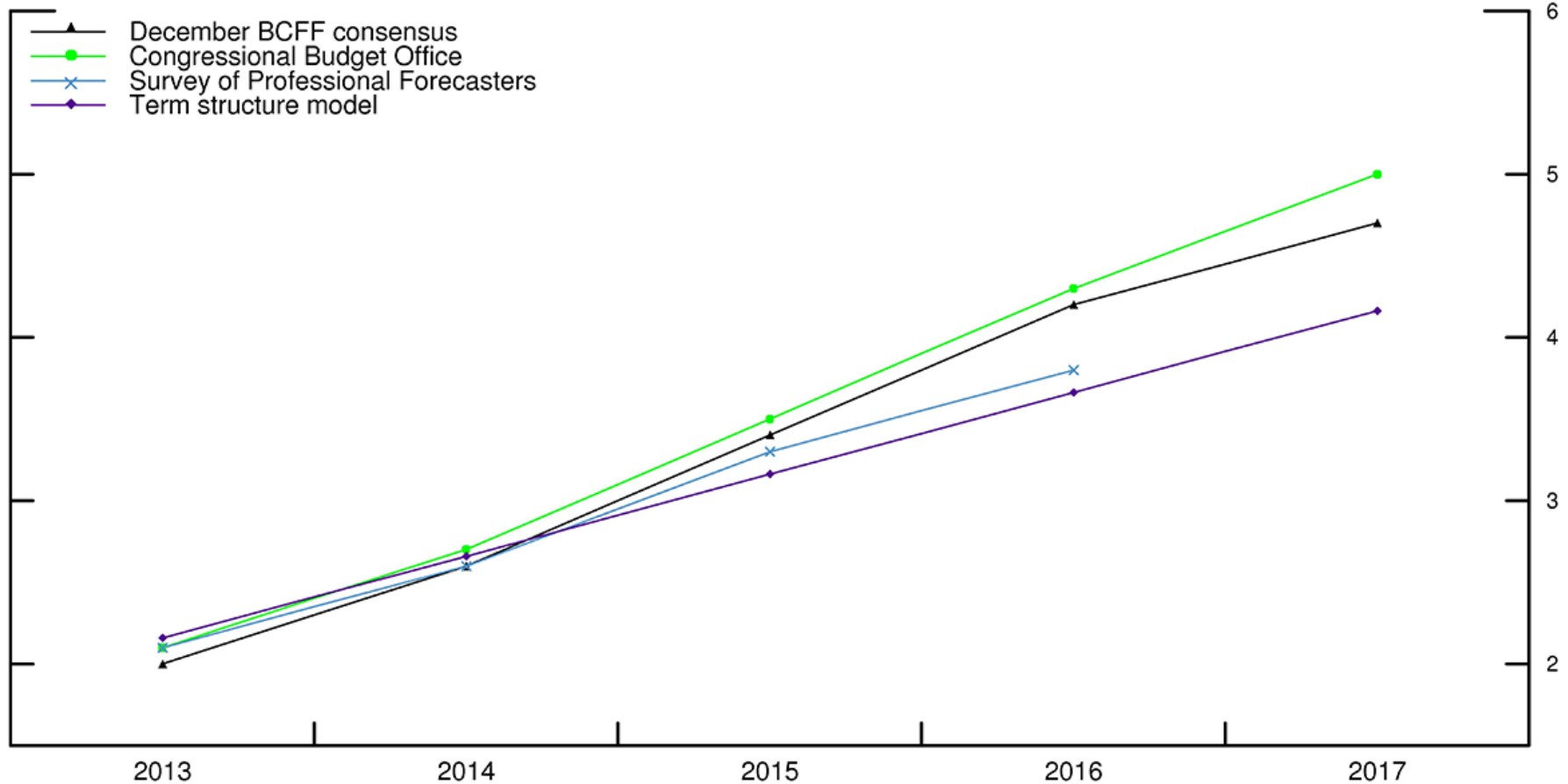
Note: Par yields. The maturity for the U.S., U.K., and German bonds is 10 years. The current maturity for the Japanese bond is 5 years, and that for the Canadian bond is 8 years.

Source: Bloomberg.

10 year treasury rate forecasts

Chart 4. Alternative 10-Year Treasury Yield Forecasts

Annual average



Note: The term structure model forecast assumes that the expected real rate and term premium components of the 10-year nominal yield as shown in chart 2 revert to their respective pre-crisis means over a 5-year period while the expected inflation component remains constant at the level at the end of 2012.

Source: For December BCFF consensus, Blue Chip Financial Forecasts (BCFF) survey, December 2012; for Congressional Budget Office, Congressional Budget Office (2013), *The Budget and Economic Outlook: Fiscal Years 2013 to 2023* (Washington: CBO), February 5; for Survey of Professional Forecasters, Survey of Professional Forecasters for 2013:Q1.

Compression between taxable and tax-exempt interest rates

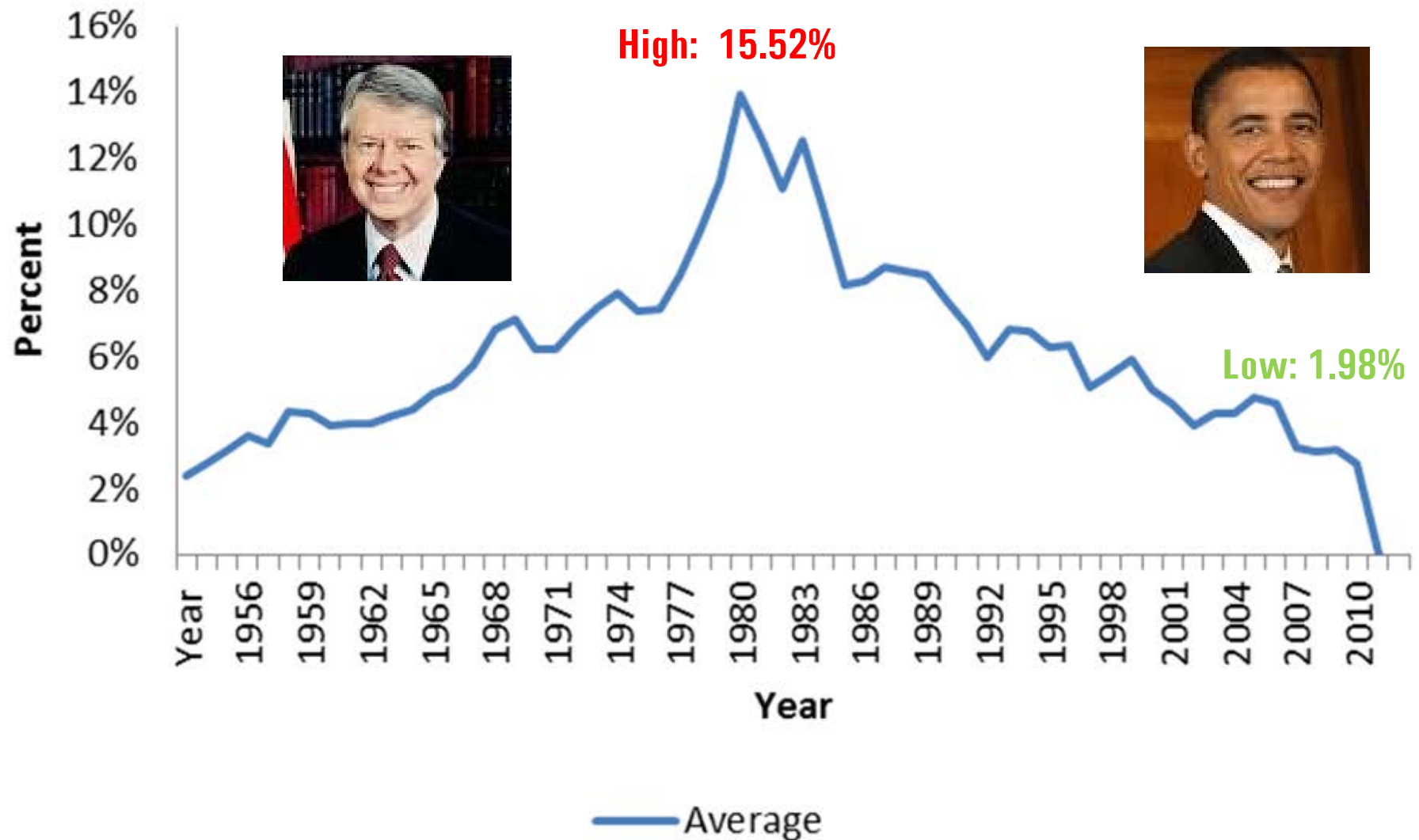
The 10 Year US Treasury Bond as Benchmark

- A “benchmark” is the basis of measurement for an interest rate, an index or peer group of bond prices or other values that is used as a reference point
- The 10 Year US Treasury: A debt owed by the United States government for a period of ten years. Each note has a stated interest rate, which is paid semi-annually. Because the United States is seen as a very low-risk borrower, many investors see 10-year Treasury Note interest rates as indicative of the wider taxable bond market. Normally, the interest rate decreases with greater demand for the Notes and rises with lower demand.

Municipal Securities Rulemaking Board

Farlex Financial Dictionary

Ten-Year Treasury: market benchmark: 1955 -2012

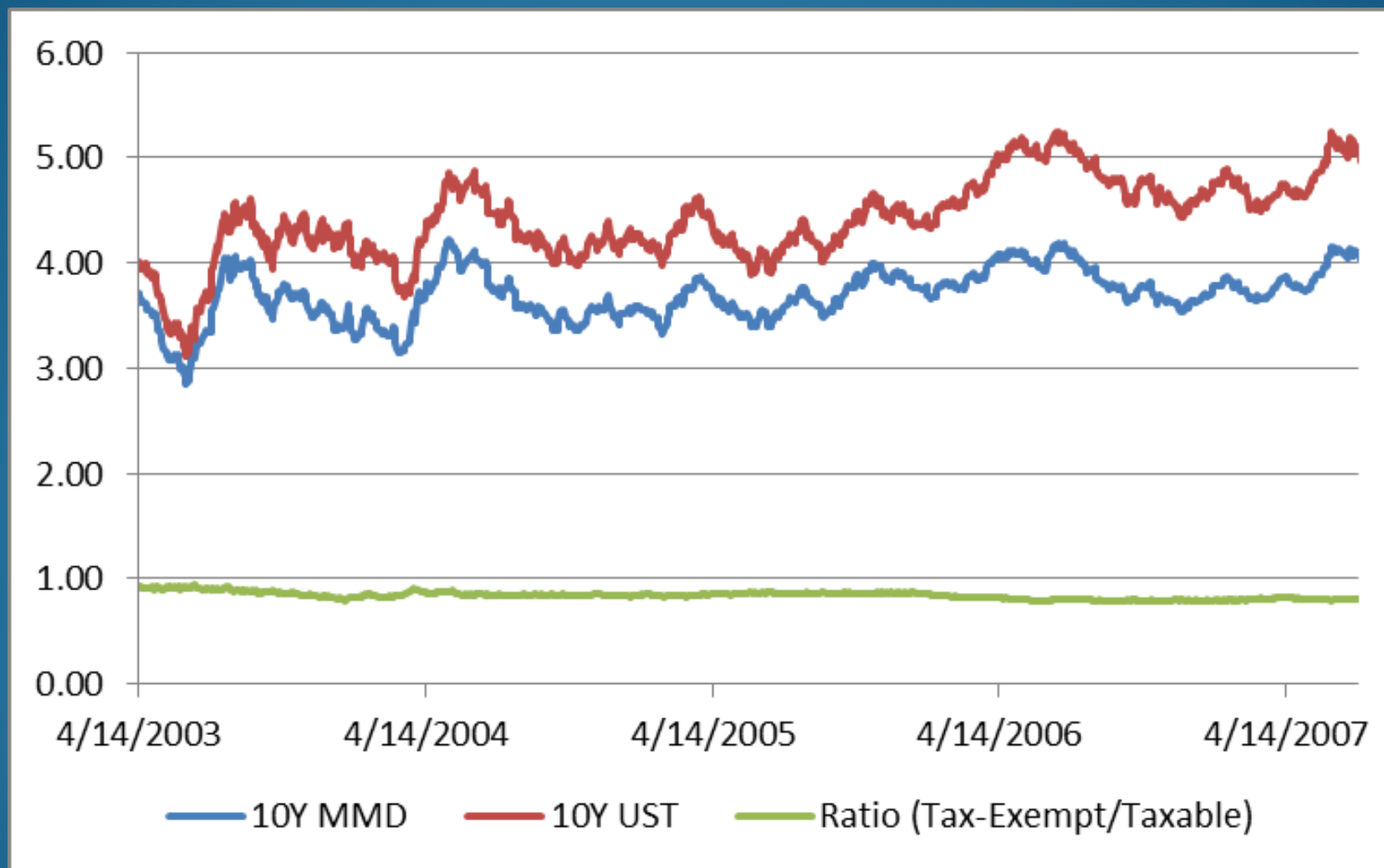


Measuring the economic benefit of tax-exempt bonds: Municipal Market Data (Index)

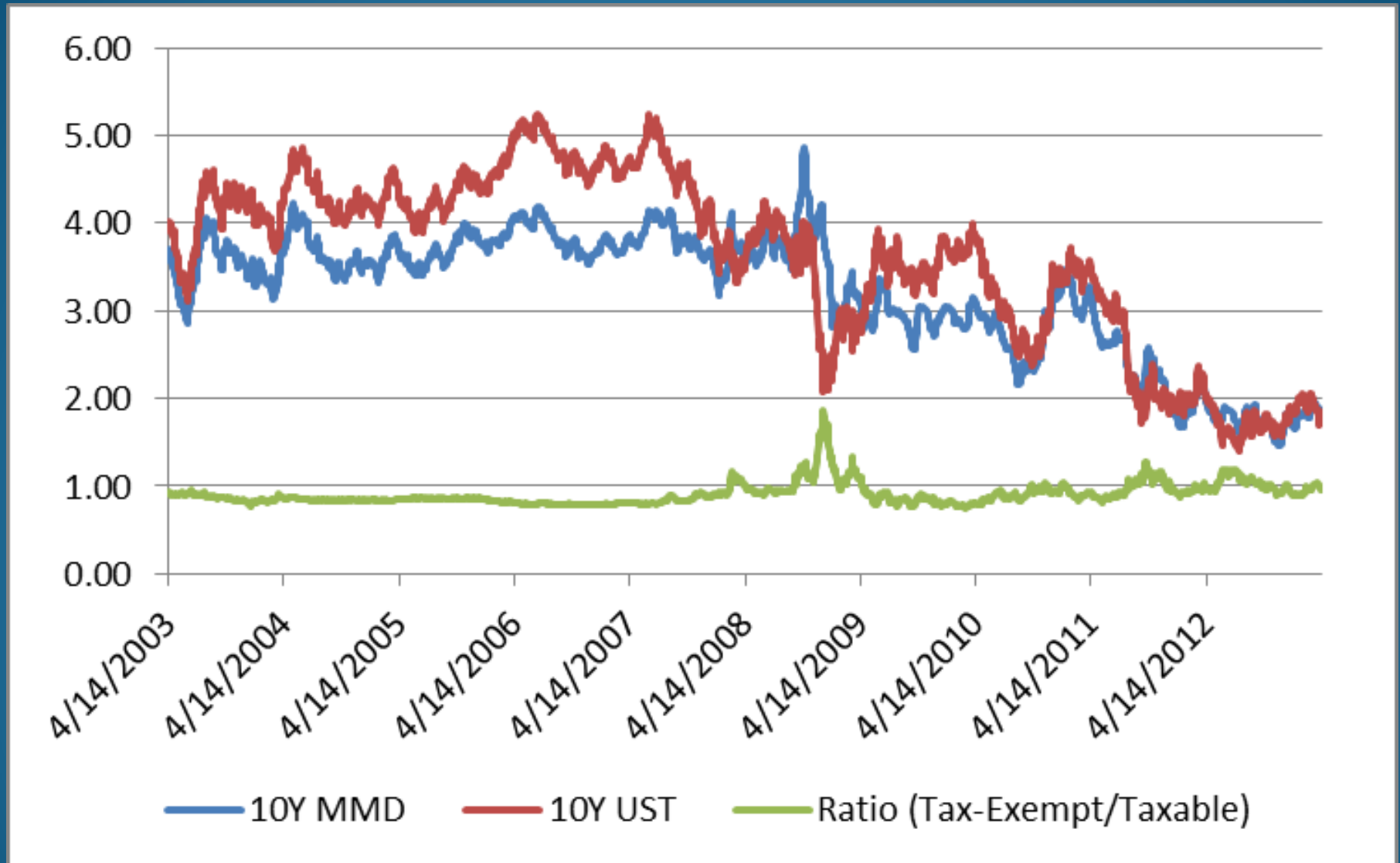
- Municipal market Data (High-grade Municipal Bond Index):
 - An “Index” is a statistical composite that can be used to measure changes in a market. An index measures market movement reflecting changes in prices or yields.
 - A “yield Curve” represents a set of interest rates for a series of maturity dates. When plotted on a graph, the compilation of these numbers produces a curve.
 - Thomson Reuters Municipal Market Data (MMD) , “AAA” Curve is a proprietary curve that provides the off-side of “AAA” rated state general obligation bonds as determined by the MMD Analysts

Municipal Securities Rulemaking Board 2012

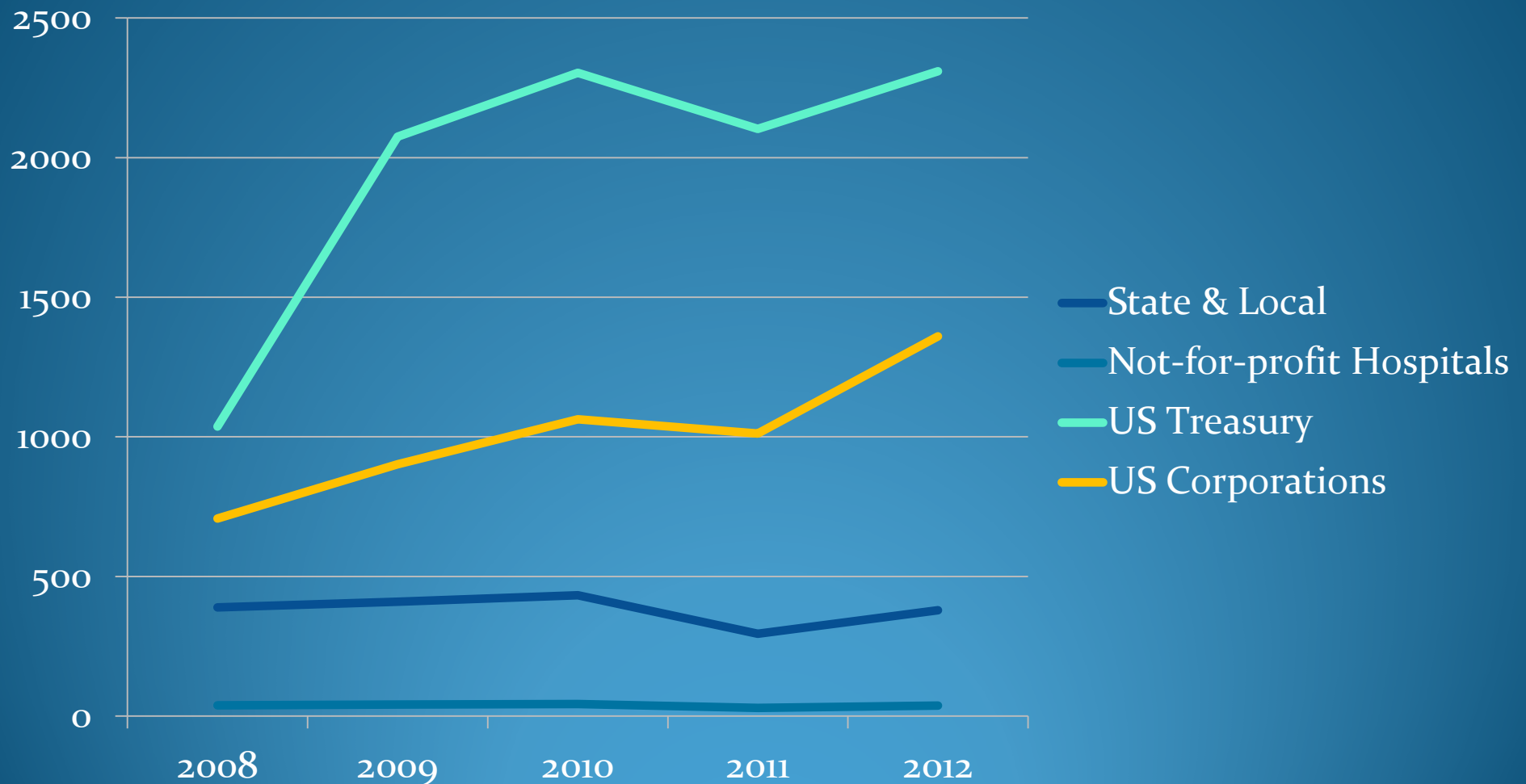
Prior to the economic melt-down, Tax-exempt bonds provided a borrower benefit of 14 to 20 basis points



During the economic crisis the interest rate on tax-exempt bonds became higher than taxable bonds



Corporate America has ramped-up its long-term borrowing: 2008 -2012

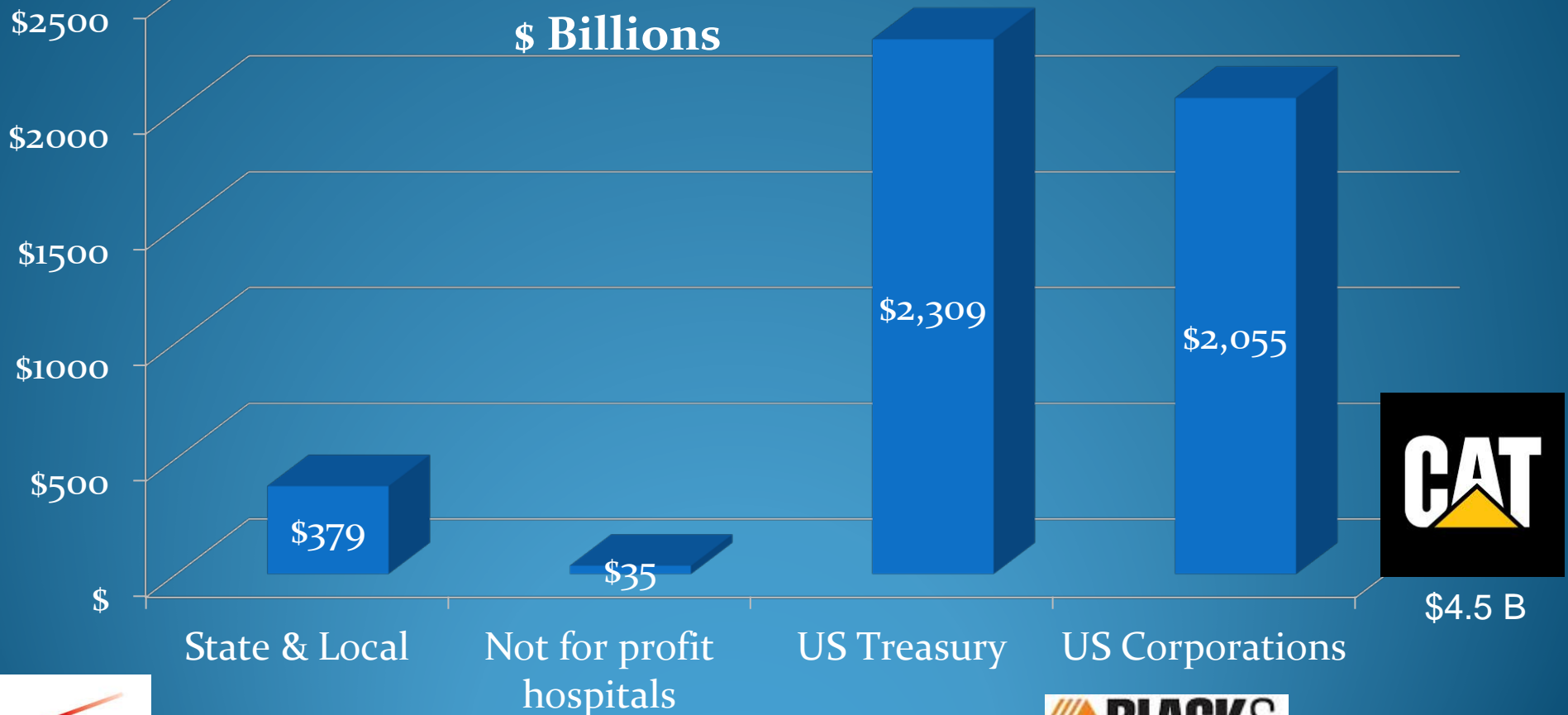




Corporate America has ramped-up its long-term borrowing



Debt Issuance 2012
\$ Billions



Lessons from recent market experience

- The advantages of lower high quality tax-exempt debt have eroded in the economic client
- Corporations have taken the lead in accessing historically inexpensive long-term debt to fund capital needs
- The immediate, near-term forecast is for continued world-wide central bank intervention, resulting in continued low long-term interest rates for high quality credits

Differences in accessing the taxable and tax-exempt markets

Issuance of taxable corporate; tax-exempt, and insured guaranteed taxable debt

Component	Corporate Taxable	Tax-exempt Debt	FHA Insured Taxable
SEC Registration	Yes	No	No
Full disclosure	Yes	Yes	No
Continuing disclosure	Yes	Yes	No
Marketing Period	Yes	Yes	Yes
Rating Agency Review	Yes	Yes	No
Debt Service Reserve	No	May be	No
No Call Period	Yes	Yes	Yes
Make whole	Yes	May be	No
Affirmative Operating Covenants	Yes	Yes	No
Mortgage Reserve Fund	No	No	Yes
Negative Arbitrage	Yes	Yes	No

\$300,000,000 Mayo Clinic Taxable Bonds

Component	Yes /No	Detail
SEC Registration	No	Unsecured General Obligation 3.774%
Credit Rating	Yes	Aa2/AA
Full disclosure	Yes	Appendix A
Continuing disclosure	Yes	EMMA
Marketing Period	Yes	Sold globally
Rating Agency Review	Yes	Rating affirmed
Debt Service Reserve	No	
No Call Period	None	
Make whole	Yes	Treasury Plus .25%
Affirmative Operating Covenants	Yes	Master Trust
Mortgage Reserve Fund	No	
Negative Arbitrage	Yes	General Corporate Purposes



Case studies of how hospitals have leveraged market access through the use of HUD mortgage insurance

St. Francis Hospital: Regional Specialty Hospital

- Located in Columbus, Georgia, St. Francis was founded in 1950 by the Franciscan Sisters of Millville, Pennsylvania.
- The Hospital was given by the Sisters to community Board of Trustees in 1972.
- The Hospital has the following characteristics:
 - 376 general acute care beds
 - 87 beds are licensed for behavioral health
 - 60 licensed residential units in an assisted living facility
- St. Francis has a 44% market share ; a major government sponsored, not for profit competitor with three hospitals, and one proprietary competitor

St. Francis Hospital: Regional Specialty Hospital

- St. Francis distinguishes itself in its market by providing specialty care in its adjacent wholly owned medical office buildings :
 - St. Francis Anesthetists, LLC
 - St. Francis Center for Breast Health Radiologists, LLC
 - St. Francis Center for Digestive Disorders, LLC
 - St. Francis Center for Surgical Care, LLC
 - St. Francis ENT, LLC
 - St. Francis General Surgeons, LLC
 - St. Francis, GI, LLC
 - St. Francis Hospital Intensivists, LLC
 - St. Francis Hospitalists, LLC
 - St. Francis OBGYN, LLC
 - St. Francis Orthopedic Institute, LLC
 - St. Francis Psychiatrists, LLC
 - St. Francis Radiologists, LLC
 - St. Francis Wound Care Physicians, LLC
 - The Bradley Center Hospitalist, LLC

St. Francis Hospital: Regional Specialty Hospital : Performance Indicators

Indicator	St. Francis
Net Patient Service Revenue	\$249,128,473
Net Income	\$2,438,473
EBITDA	\$18,792,001
Occupancy	Acute: 71.28%; Behavioral: 66%
Days Cash-on-hand	62.75 days
Debt Service Coverage Ratio	2.83 times

St. Francis Hospital: Challenge of Refinancing High Cost and Bank Debt while and Expanding to Remain the Market Leader



St. Francis Hospital: Refinanced debt & expansion

Component	Comment
Project Cost	\$222,464,272
Borrower	St. Francis Hospital & LLC Affiliates
Recourse to St. Francis Corporation	None
Governance & Control	St. Francis Hospital, Inc.
Cash Equity Contribution	\$12,464,727
Foundation Guarantee	None
Collateral	Buildings, Land, & Revenue of St. Francis
Loan Amount	\$210,000,000
Rating	Aa2/AA
Interest Rate	4.78%

Mennonite General Hospital: Refinancing & Expansion

- Located in the central highlands of Puerto Rico, Mennonite General was founded in 1944 by medical missionaries from Indiana serving alternative military service
- The Hospital is a “system” of four institutions:
 - Mennonite General Hospital - Cayey
 - Mennonite General Hospital - Aibonito
 - Mennonite General Hospital - Caguas
 - Mennonite Psychiatric Hospital - CIMA, Aibonito
- The Hospital also operates a free standing Outpatient Center in Cidra
- The Hospital sponsors a health plan
- The hospital manages three free-standing emergency rooms for the local Commonwealth Government

Mennonite General Hospital: Performance indicator

Indicator	Mennonite General
Net Patient Service Revenue	\$167,960,116
Net Income	\$9,183,303
EBITDA	\$22,305,642
Occupancy	82.61%
Days Cash-on-hand	51.28 days
Debt Service Coverage Ratio	1.94 times
Market Share	77.1%

Mennonite General Hospital: Refinancing & Expansion



Mennonite General Hospital: Refinancing & Expansion

Component	Comment
Project Cost	\$ 133,808,384
Equity Contribution	\$ 3,842,284
Borrower	Mennonite General Hospital, Inc.
Governance & Control	Mennonite General Hospital – 501(c)3
Cash Equity Contribution	\$ million
Church Guarantee	None
Collateral	Buildings, Land, & Revenue of Mennonite
Loan Amount	\$129,966,100
Rating	Aa2/AA
Interest Rate	5.85%

New Orleans East Hospital

- Closed by Hurricane Katrina on August 29, 2005
- Total replacement project
- Located in East Orleans, Orleans Parish, Louisiana
- Prior medical facilities consisted of:
 - Methodist Hospital: 300 beds
 - Lakeview Specialty Hospital : 96 beds
- Pre-Katrina population: 205,000
- Current population: 130,612 – 2016 forecast: 152,331
- Nearest Emergency Room 12 miles away in Downtown New Orleans
- Community sits aside Interstate 10 and the Industrial Canal & high rise bridge

New Orleans East Hospital

- New facility to be 80 beds; 20 as LTAC
- Project to make use of existing concrete structure (6 stories) which will be complete rehabilitated
- Franciscan Missionaries of Our lady (FMOL) will manage the operations of the Hospital to include the “ramp-up” and initial opening
- Daughter of Charity will construct, operate and fund a Outpatient Primary Care Center on property owned by the Hospital
- Construction is secured by a Guaranteed Maximum Price
- The Hospital has affiliation agreements with the LSU Health Sciences Center and Touro Infirmary
- There is strong community support for the project

New Orleans East Hospital: Project Performance Indicators

Indicator	New Orleans East Hospital
Net Patient Service Revenue	\$ 58,021,000
Net Income	(\$417,000) FY 2015
EBITDA	\$ 10,105,000
Occupancy	80.2%
Days Cash-on hand	50.63 days
Debt Service Coverage Ratio	1.47 times
Market Share	21.5%

New Orleans East Hospital: the Challenge Replacement Facility / Start-up



New Orleans East Hospital: Start-up

Component	Comment
Project Cost	\$ 137,941,340
Borrower	Parish Hospital Service District for the Parish of Orleans –District A
Recourse to City of New Orleans	None
Working Capital : Provision of Public Services	\$ 51,802,733.05 includes purchase of hospital property for \$16,502,119.32
Governance & Control	Parish Hospital Service District for the Parish of Orleans –District A
Cash Equity Contribution: FEMA; State; HRSA	\$ 24,284,421
Guarantee by City & State	None
Collateral	Buildings, Land, & Revenue of Hospital
Loan Amount	\$97,460,300
Rating	Aa2/AA
Interest Rate	3.82%

Einstein Health Network (AEHN): Market share

- AEHN's strategic plan called for entering a new market and bring high quality clinic services closer to people living in the northwest suburbs of Philadelphia
- Montgomery County was identified as the target community:
 - Population of 313,000, growing at 3.2%
 - An aging population is anticipated to require more healthcare services
 - There are three limited scope of service hospitals in the area
 - 60% of county patients seek care outside of the county, many travel to Philadelphia to meet their healthcare and hospital needs
- A partnership is formed with one of the local hospitals, Montgomery Hospital Medical Center, which has served Montgomery County for 116 years.

Einstein Health Network: The Challenge of market share and the need for new markets: New Regional Hospital



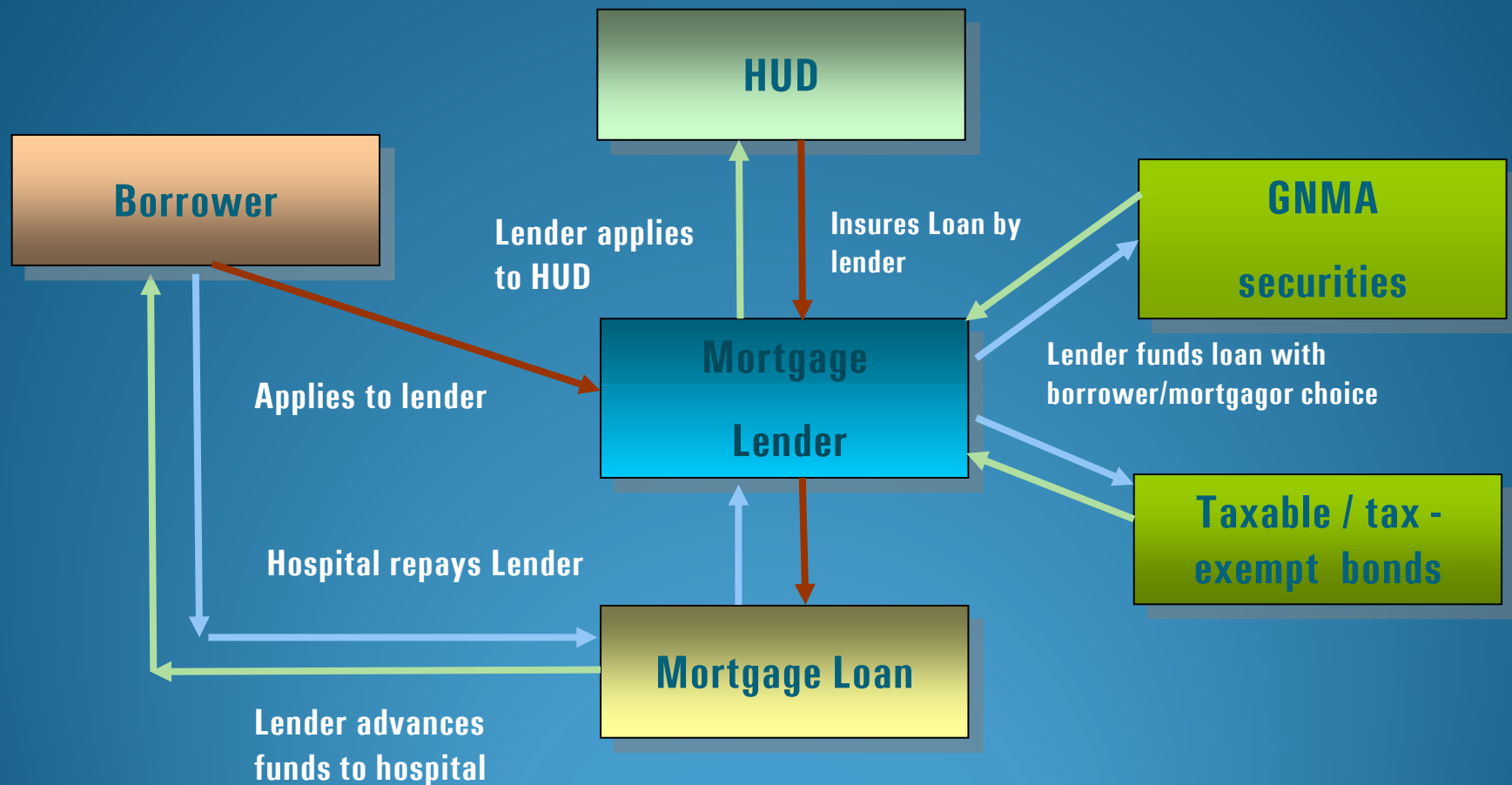
Einstein Health Network (AEHN): New Regional Hospital

Component	Comment
Project Cost	\$340,116,194
Borrower	New Regional Medical Center (NRMC)
Recourse to AEHN	None
AEHN support	\$20 million cash working capital/\$20million LOC
Governance & Control	AEHN sole corporate member
Cash Equity Contribution	\$47.6 million
AEHN Guarantee	None
Collateral	Buildings, Land, & Revenue of NRMC
Loan Amount	\$292,500,000
Rating	Aa2/AA
Interest Rate	5.38%



Understanding how the newest HUD hospital insurance product, 223(f) refinancing can work for you

The Borrower applies to the mortgage lender for an Insured Loan



Successful project characteristics

- ***Needed and Necessary:*** The hospital evidences historically or by independent projection that hospital responds or will respond to unmet community lack of inpatient hospital services and not take patients from competing provides
- ***Practical & Functional Design:*** The proposed construction is efficient and effective and meets current local hospital code requirements
- ***Financially Feasible:*** Based on projects, generally independently provided, the hospital will produce sufficient cash flow to cover initial debt service by at least 1.40x or greater
- ***Operationally Sustainable:*** A multi-year forecast demonstrates that based on reasonable assumption the hospital can sustain its operations, provide for routine improvements and grow in net operating income
- ***Strong Physician & Community Support:*** Current or proposed physician staff are project supportive and will continue to admit or will admit patients. There is no organized community opposition to the proposed project

Section 223(f) Refinancing criteria

- Permits, for the first time, HUD insurance of transaction which have as their principal purpose acquisition of property, plant and equipment of other entities:
 - *Acquisition* means the purchase by an eligible mortgagor of an existing hospital facility and ancillary property associated therewith.
- HUD/ FHA may now insure transactions in which capital debt without construction is financed. Capital Debt:
 - *Capital debt* means the outstanding indebtedness used for the construction, rehabilitation, or acquisition of the physical property and equipment of a hospital, including those financing costs approved by HUD.

Section 223(f) Threshold Requirements

- Aggregate operating margin of at least 0%, when calculated from the three most recent annual audited statements.
- The hospital must have an average debt service coverage ratio of at least 1.40 when calculated from the three most recent annual audited statements, or....
- HUD will recast the operating margin and debt service coverage ratio for prior periods by applying its estimate of the projected interest rate at the time the mortgage is expected to close in lieu of the historical interest rate(s).
- The hospital must document that it provides an essential community service and that its financial performance would be materially improved by refinancing its existing capital debt.