Healthcare Sector

Bond issuance is a primary financing avenue for hospitals -- Not-for-profit, government owned and other not-for-profit healthcare institutions, such as FQHCs, to raise capital. Hospitals are capital intensive and may seek to raise capital for a number of different reasons, including, but not limited to, acquiring land, expanding facilities, purchasing equipment or refinancing outstanding debt. Depending upon the type of project being financed, factors that impact specific credits include construction execution, facility management, pressures from competitors and patient demand. While these risks are present in most classes of municipal bonds, there are unique factors specific to hospitals that complicate credit risk.

Over the past several years healthcare and the apportionment of costs associated with such care has become highly politicized. The implementation of the Affordable Care Act, the state level decisions to expand Medicaid or not, and recently, the attempts to roll back the Affordable Care Act all affect hospital operations and profit margins. Decisions made at the local, state, and federal level affect numerous issues including, but not limited to, patient length of stay, insurance reimbursement, drug pricing and labor costs. Such decisions can significantly impact the cash flow of hospitals and thus affect their ability to operate efficiently. For example, a reduction in publicly available health insurance, could lead to a larger number of uninsured individuals seeking services, resulting in higher bad debt. There may also be a political incentive to keep a struggling hospital open in an area that is underserved or where the hospital is a major local employer. Factoring potential legislative shifts into credit analysis allows LCP to estimate the potential effects on holdings given possible changes in the overall healthcare environment.

Another important factor in determining the liquidity risk of a hospital is the payor-mix of insurance-type for a particular hospital's patients. A typical payor-mix consists of some combination of individuals on Medicaid, Medicare, private insurance, and those who are completely uninsured. Different insurance types offer different levels of reimbursement and different requirements for reimbursement. Hospitals in low-income areas may have more patients insured under Medicaid, resulting in hospitals in those areas receiving lower reimbursement rates, resulting in difficulty covering expenses and generating profits. Hospitals also offer some form of charity care for individuals who are uninsured and cannot pay. However, as more patients are insured under public options, the amount of charity care that a hospital offers is expected to decrease. Ultimately, different payor-mixes and the different levels of reimbursement that accompany them can influence a hospital's ability to cover operating expenses and generate profits.

Other structural issues can also affect the credit risk of a hospital bond. Hospitals that offer specialized treatment and are able to attract specialists may have less difficulty servicing debt, especially given this treatment often generates higher revenues. Hospitals may be part of a larger network, resulting in a higher credit rating. Smaller, stand-alone hospitals may be susceptible to acquisition from larger, nearby hospitals or hospital networks. This may be a credit positive, in cases where the larger hospital provides support to the smaller one, or a credit negative, in a scenario where the larger hospital strips the smaller one of revenue-generating assets without incorporating it into the obligated group.

Healthcare expenses continue to grow in the United States and accounted for 17.9% of the GDP in 2017, or $10,740 per person. The ongoing financial issues attendant to providing healthcare will continue to be a major issue for this country. Anticipating changes in coverage and regulation, as well as assessing more conventional credit risk, is an integral component of determining the potential performance of hospital bonds moving forward. Municipalities often issue economic development bonds, sometimes known as land-secured bonds, to raise capital for development projects. The proceeds from economic development bonds are often used to finance the construction of infrastructure necessary for a new project, such as roads or sewers, but can also be used to revitalize existing structures. Such development projects can range from neighborhood development to commercial area revitalization, and thus can vary significantly in scope and size. There are typically two phases to evaluating the credit risk of these projects: construction/development risk and revenue generation to repay debt risk. These projects generally focus on housing or retail developments in undeveloped, blighted or generally underutilized areas.

If the bond issuance is being used to finance the construction of a project, then the completion schedule should be an integral part of analysis. There are many factors that can help to determine the extent that construction risk is present. Assessing the complexity of the project and the track record of the developer can help to determine how likely the project is to be completed on time and on budget. Environmental regulations and issues regarding permits or zoning can lead to substantial delays in certain cases. Such delays are common for construction projects, yet they are often anticipated and accounted for through feasibility studies.

Projects that are undertaken in conjunction with a city or county, but require special approval from the state, may have a higher risk of construction delay than those which only rely on approval from the entity that is partnered in the project. In most cases, the bond covenant identifies a worst-case scenario for delays or other construction hurdles and stipulates that the issuer maintain a reserve fund with capital sufficient to withstand those delays. This allows the debtor to continue to service debt despite lack of revenue from project completion.

Different types of economic development projects result in different methods of servicing debt. A housing development may use property taxes to service their debt, while the redevelopment of main street may be backed by a combination of property and sales-tax revenue. Sales-tax revenue, dependent on successful sales levels at the property can be inferior to property revenue as a source of repayment. It is also important to note, the property tax bond secured by the tax lien primes mortgage debt on the property. Demographic data, such as per capita income and population trends, can allow for projections of future demand for a given project. The project developer's prior success with marketing or running a similar entity may provide insights into future demand and durability of the project.

Often, economic development bonds are issued for revitalization purposes. Addressing the reason for revitalization can help provide insights into future performance and potential risk factors. If the area is blighted, in the current over retailed environment, assessing the demand for more retail is essential. As another example, a revitalization project in an area affected by natural disaster indicates that without necessary safeguards, the new development may be susceptible to similar issues in the future. Understanding how these factors have affected past developments and investigating the ways in which they will be mitigated in future is an integral part of analysis.