American Hospital Association

Protecting the Promise of Care

Hospital Capital Financing

Background

It's essential that America's hospitals have access to needed capital to improve community health care, increase jobs and support the local economy. Better access to capital helps hospitals upgrade facilities, increase patient capacity or invest in clinical and information technology – all of which support the AHA's *Health for Life* framework. Three key efforts are helping hospitals address the challenges associated with the capital crunch precipitated by the 2008 recession.

Build America Bonds. Build America Bonds are a new borrowing tool for state and local governments. Created as part of the *American Recovery and Reinvestment Act of 2009* (ARRA), these conventional, taxable bonds are available for use by public hospitals for new construction until the program sunsets at the end of calendar year 2010. Under the program, the Treasury Department makes direct payments to borrowers to subsidize a portion of their borrowing costs in the amount of 35 percent of the interest on the bonds. Build America Bonds are an alternative to traditional, tax-exempt bonds and can be used for the same purposes, though not to refinance existing debt. There is no limit on funding.

In his fiscal year 2010 budget, President Obama proposed making the program permanent, expanding it for use by 501(c)(3) not-for-profit hospitals and allowing the refund of current obligations. Obligations under the new, permanent program would be subsidized at 28 percent of the interest cost of the bonds.

Incentives to Buy Tax-Exempt Hospital Bonds. The ARRA raised the limit on the amount of interest expense banks can deduct for debt incurred to purchase tax-exempt bonds. This change, set to expire at the end of calendar year 2010, expands the ability of banks to buy tax-exempt hospital bonds and hold them in their own portfolios. Specifically, the ARRA changes the "bank-qualified" bond limit from $10 million to $30 million and allows each borrower its own $30 million limit, rather than imposing the limit on each issuing authority. This year, Congress will consider extending the expiration date of this provision. Principal sponsors of the 2009 legislation were Reps. Richard Neal (D-MA), Barney Frank (D-MA), Mike Capuano (D-MA) and Sen. Jeff Bingaman (D-NM).

Federal Home Loan Bank Letters of Credit. The *Housing and Economic Recovery Act of 2008* included a provision to allow Federal Home Loan Banks to use letters of credit to guarantee tax-exempt bonds for hospitals and other entities. The provision expires at the end of calendar year 2010. Congress will consider extending the expiration date this year. Principal sponsors of the 2008 legislation were Rep. Sander Levin (D-MI) and Sen. Jay Rockefeller (D-WV).

AHA View

Hospitals continue to grapple with financial market turmoil resulting from the recession of 2008. In a recent survey, only nine percent of hospitals reported they were beginning to see improvement in access to capital while nearly a quarter indicated the situation continues to get worse. As they work to continue to lower costs, hospitals need to address the cost of borrowing for needed capital improvements and these recently enacted changes have proven useful to that end.

To date, Build America Bonds have provided a viable alternative for public hospitals in a difficult market. The AHA believes they should be made permanent, expanded to not-for-profit hospitals and made available for needed refinancing. Rating agencies have estimated that nearly $19 billion in letters of credit are due to be renewed over the next two years. Hospitals also must address billions of dollars in variable rate debt costs by refinancing to more favorable rates. The Build America Bond program is a useful tool in conjunction with traditional, tax-exempt financing and is instrumental in addressing these costs. A recent survey of hospitals found that 59 percent of not-for-profit hospitals would consider using Build America Bonds if they were made available.

Enacted in 2009, the incentives for banks to purchase tax-exempt bonds have greatly assisted many small hospitals in raising capital despite adverse market conditions, the bank financial crisis and the collapse of the traditional credit enhancement market. Through a limited incentive for banks to purchase bonds or make loans at tax-exempt interest rates, a number of community hospitals were able to complete critical financing in 2009 and 2010. This incentive benefits small hospitals and other health care facilities, which have a difficult time on Wall Street. In fact, thanks to these incentives as well as economic stimulus funding, many capital projects were able to break ground.

Small, non-profit hospital borrowers often do not have established bond ratings, which are a barrier to accessing the market. The incentive offered to banks through the ARRA encourages local bank purchasers to evaluate directly these borrowers based on their community roles. The enhanced ability of banks to buy and purchase tax-exempt debt has proven instrumental to many hospitals, particularly smaller institutions, in providing funding for necessary capital improvements. The $10 million limit that the ARRA raised to $30 million had been in effect for 23 years and was not indexed for inflation, so it had become almost impossible for hospitals to maximize cost savings in local bank financings. The AHA supports legislation to permanently set the bank-qualified bond limit at $30 million.

Allowing letters of credit from the Federal Home Loan Banks helps local communities raise funds for health care facilities and other important, tax-exempt initiatives, and the AHA supports legislation to make the program permanent. Under this program, banks may provide letters of credit for hospital tax-exempt financings, which has proven instrumental in helping hospitals obtain needed capital in the wake of the collapse of bond insurers.

With a Federal Home Loan Bank letter of credit, the bond is issued with an AAA or AA credit rating, reducing financing costs and increasing the marketability of the bond. The provision assists underserved, small issuers and borrowers of tax-exempt bonds traditionally ignored by larger credit enhancement providers, even when the bond insurance industry was more viable. The federal government provides no funding for this program. Approximately 27 transactions undertaken since 2008 involved health care facilities and hospitals (elder housing, nursing homes, wellness centers, rehab facilities, hospitals).