



Hospital Capital Financing

Background

It is essential that America's hospitals have access to needed capital to improve community health, increase jobs and support the local economy. Better access to capital helps hospitals upgrade facilities, meet growing patient needs and invest in clinical and information technology. But for many hospitals obtaining adequate capital financing remains a serious challenge.

Moody's Investors Service, in its 2012 "Outlook," recently noted, "...the preponderance of credit factors facing the industry is unequivocally negative, and is expected to remain negative for at least the next several years." Likewise, Standard & Poor's reports a negative outlook for hospitals for 2012 and 2013. Three temporary financing options – stemming from the 2009 *American Recovery and Reinvestment Act* (ARRA) and the 2008 *Housing and Economic Recovery Act* – helped ease the credit crunch for all types of hospitals through 2010 and allowed them to finance capital projects in a tough economic environment. But Congress allowed the programs – Build America Bonds, bank qualified bonds and Federal Home Loan Bank letters of credit – to expire. Also expiring last year was a special rule that allowed certain critical access hospitals (CAH) to qualify for the Hospital Mortgage Insurance program at the Department of Housing and Urban Development (HUD).

AHA View

The AHA is seeking enactment of legislation that can help hospitals lower their capital costs and, consequently, lower the cost of the nation's health care. **Congress should renew these important programs and make them permanent.** They have helped a broad range of hospitals – from small rural facilities to large public health systems – address the cost of borrowing for needed capital improvements, and they remain a vital financial tool as hospitals continue to grapple with financial market turmoil resulting from the 2008 recession.

Build America Bonds. Build America Bonds allowed public entities – like municipal or county-owned hospitals – to issue bonds subsidized by the federal government for 35 percent of their interest cost. Build America Bonds were alternatives to traditional, tax-exempt bonds and could be used for the same purposes, though not to refinance existing debt. There was no limit on funding. **Build America Bonds provided a viable alternative for public hospitals in a difficult financial market. The program should be made permanent, expanded to not-for-profit hospitals and made available for needed refinancing.**

President Obama's fiscal year 2013 budget request would make the Build America Bonds program permanent at a federal subsidy level equal to 30 percent through 2013 and 28 percent of the coupon interest on the bonds thereafter. This proposal also would expand the eligible uses for Build America Bonds to include the following: (1) original financing for governmental capital projects, as under the initial authorization of Build America Bonds; (2) current refundings of prior public capital project financings for interest cost savings where the prior bonds

are repaid promptly within 90 days of issuance of the current refunding bonds; (3) short-term governmental working capital financings for governmental operating expenses (such as tax and revenue anticipation borrowings for seasonal cash flow deficits), subject to a 13-month maturity limitation; and (4) financing for Section 501(c)(3) nonprofit entities, such as nonprofit hospitals and universities.

Incentives to Buy Tax-Exempt Hospital Bonds. Another lapsed ARRA measure, referred to as “bank qualified” (BQ) bonds, raised the limit on the amount of interest expense banks can deduct for debt incurred to purchase tax-exempt bonds. This change expanded the ability of banks to buy tax-exempt hospital bonds and hold them in their own portfolios. Specifically, ARRA changed the BQ bond limit from \$10 million to \$30 million and allowed each borrower its own \$30 million limit, rather than imposing the limit on each issuing authority. Before ARRA’s passage, the \$10 million “small issuer” limit had been in effect for 23 years, and since it was never indexed for inflation, it had become virtually 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. Small, non-profit hospital borrowers often do not have established bond ratings, which is a barrier to accessing the market. BQ bonds helped many small hospitals raise 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. Thanks to its incentives and funding, many capital projects were able to break ground. The program’s demise means that many small communities and authorities, as well as many small not-for-profit borrowers, could be denied access to capital, and local services could be adversely affected. *The Highway Investment, Job Creation and Economic Growth Act of 2012* (S.1813), includes a provision authored by Sen. Jeff Bingaman (D-NM) that would extend this provision through 2012.

Federal Home Loan Bank Letters of Credit. The third expired program provided a new credit enhancement option to the 12 Federal Home Loan Banks (FHLBs), which were created 80 years ago to provide a steady stream of low-cost capital to the housing market. The 2008 *Housing and Economic Recovery Act* allowed FHLBs’ more than 8,000 local members to provide highly rated letters of credit in support of tax-exempt bonds, including those used to finance health care facilities.

Allowing letters of credit from FHLBs helped local communities raise funds for health care facilities and other important, tax-exempt initiatives, and the AHA supports legislation to reauthorize the program and make it permanent. It enabled banks to provide letters of credit for hospital tax-exempt financings,

which helped a number of small and rural hospitals obtain needed capital in the wake of the collapse of bond insurers. With a FHLB letter of credit, the bond is issued with a credit rating of AAA or AA, reducing financing costs and increasing the marketability of the bond. The provision assisted 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 provided no funding for the program.

Hospital Mortgage Insurance (FHA 242). HUD has helped to improve health care access to rural America through the FHA 242 loan program. To be eligible for this loan program, a facility must primarily provide acute care services (generally short-stay, inpatient, hospital visits) rather than non-acute care (nursing home care, other long-term visits).

Many CAHs provide a significant level of non-acute or long-term services, and therefore do not qualify for the FHA 242 loan program based on the average length of stay at the CAH. Plus, some CAHs operate nursing homes. In 2006, Congress recognized the uniqueness and importance of these hospitals and passed the *Rural Health Care Capital Access Act*, which provided an exemption to the acute care provision in the FHA 242 loan program for critical access facilities. The exemption expired on July 31, 2011.

The Rural Health Care Capital Access Reauthorization Act (S. 1431), introduced by Sen. Herb Kohl (D-WI) and cosponsored by Sens. John Thune (R-SD), Mike Johanns (R-NE), and Jon Tester (D-MT), would provide a five-year extension of the exemption. Without the exemption, many rural hospitals would not qualify for low-cost loan insurance because the hospital operates a nursing home or has a long average length of stay. As a result, many rural hospitals face higher financing costs on construction and renovation loans.