American Hospital Association

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, increase patient capacity and invest in clinical and information technology. But obtaining adequate capital financing remains a serious challenge for many hospitals across the nation.

A March 2 *Bloomberg Brief* on municipal markets reported that "relative borrowing costs for hospitals selling municipal debt have increased by almost half in the last four months." Moody's Investors Service also issued a negative outlook for the not-for-profit health care industry, and it expects hospital rating downgrades to exceed upgrades in 2011. 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 during the past two years and allowed them to finance capital projects in a tough economic environment. But the programs – Build America Bonds, bank qualified bonds and Federal Home Loan Bank letters of credit – expired at the end of 2010.

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. In a recent survey, only 9 percent of hospitals reported they were beginning to see improvement in access to capital, while nearly 25 percent said the situation is getting worse.

Build America Bonds. One of the expired ARRA measures, 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 an alternative 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 market. The program should be made permanent, expanded to not-for-profit hospitals and made available for needed refinancing.**

*The Build America Bonds Extension Ac*t (H.R. 747), introduced by Rep. Adam Schiff (D-CA), would continue the program through the end of 2012 and allow tax-exempt hospitals to qualify. But the bill would lower the interest subsidy to 28 percent. In addition, the *Building American Jobs Act of 2011* (H.R. 992), a bill introduced by Rep. Sander Levin (D-MI), would renew the program for two years, but only for public entities, and provide a 32 percent interest subsidy in 2011 and a 31 percent subsidy in 2012.

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, the 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 economic stimulus 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. H.R. 992 also would revive the BQ bond program and extend it through the end of this year.

Federal Home Loan Bank Letters of Credit. The third expired program provided a new credit enhancement option to the 12 Federal Home Loan Banks (FHLB), which were created 79 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 the 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 an AAA or AA credit rating, 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. H.R. 992 would renew the program through 2011.