

# HEALTHCARE FINANCE

## A LOOK AHEAD TO 2021

Greg Blonde  
Partner  
Orrick, Herrington & Sutcliffe LLP

Jennifer Brown  
Managing Director  
Ponder & Co.

Eric Shumsky  
Partner  
Orrick, Herrington & Sutcliffe LLP

Bradley Wolters  
Director, Federal Government Relations  
Marshfield Clinic Health System



# Today's Speakers



**Greg Blonde, Partner**

Orrick, Herrington & Sutcliffe LLP

T +1 503 943-4823 E [gblonde@orrick.com](mailto:gblonde@orrick.com)

Greg Blonde is a Portland-based partner in Orrick's Public Finance group. Greg represents borrowers, conduit issuers, underwriters, commercial banks and others on a wide variety of tax-exempt and taxable bond financings, with a focus on nonprofit healthcare and senior living. Over the past 20 years, Greg has completed financings for nonprofit healthcare providers, nonprofit senior living providers, airports, public power agencies, cities, counties and other municipalities, using virtually every debt structure available to the public finance community.



**Eric Shumsky, Partner**

Orrick, Herrington & Sutcliffe LLP

T +1 202 339-8464 E [eshumsky@orrick.com](mailto:eshumsky@orrick.com)

Eric Shumsky is a Washington DC-based partner in Orrick's Supreme Court & Appellate group. Eric is a nationally recognized appellate lawyer who has represented a who's who of leading companies, including AT&T, DISH Network, Facebook, Genentech, Gilead, KPMG, LG Electronics, LinkedIn, Lyft, Microsoft, Morgan Stanley, Netflix, Norfolk Southern, Synopsys, Twitter, and Union Carbide. He has briefed and argued issues as diverse as patent and copyright, labor and employment, preemption, punitive damages, environmental law, national security, and foreign sovereign immunity. Reuters, in a report reviewing some 17,000 practitioners, identified Eric as part of an "elite cadre" of 75 lawyers who are "the most influential members of one of the most powerful specialties in America: the business of practicing before the Supreme Court." He has been a primary author of more than 100 briefs in the Supreme Court alone.



**Jennifer Brown, Managing Director**

Ponder & Co.

T +1 312 953 1325 E [jbrown@ponderco.com](mailto:jbrown@ponderco.com)

Jennifer Brown has more than 20 years of experience in healthcare finance and investment banking. She joined Ponder & Co. in 2002 and is a managing director for the Capital Advisory Group, serving as financial advisor to a variety of healthcare clients, primarily acute care hospitals and health systems nationwide. She has maintained long-standing relationships with her clients through an emphasis on strategic capital planning and consistent, unbiased advice and advocacy in the capital markets. Prior to joining Ponder & Co., Ms. Brown was an investment banker with the healthcare group at J.P. Morgan Securities, Inc. She also worked for a large integrated healthcare system in Chicago where she was responsible for negotiating managed care contracts on behalf of the hospital and its physicians, and spent five years in the equity operations area of Goldman, Sachs & Co.



**Bradley Wolters, Director, Federal Government Relations**

Marshfield Clinic Health System

T +1 202 321 5466 E [wolters.bradley@marshfieldclinic.org](mailto:wolters.bradley@marshfieldclinic.org)

Brad Wolters is the Director of Federal Government Relations for the Marshfield Clinic Health System, an integrated health system based in Wisconsin. Before joining Marshfield he was an Executive Vice President at Signal Group, a boutique government affairs and public affairs consulting firm where he co- led the healthcare practice. From 2013-2016 he served as the White House Liaison at the US Department of Health and Human Services (HHS) where he was responsible for coordination between the Department and the White House, and over saw the 160+ political appointees. He also served as the Chief of Staff to the Assistant Secretary for Health at HHS (2010-2013). Prior to serving at HHS he worked on Capitol Hill for Senators Tom Daschle, Herb Kohl and Barack Obama.

# ACA SUPREME COURT ARGUMENTS

## **CUTTING TO THE CHASE:**

A Lawyerly Mess, But the  
ACA Very Likely Survives





# ACA Supreme Court Arguments – How We Got Here

- Congress enacts the ACA (2010): “Eat your broccoli!”
- “Death panels,” etc.
- *King v. Burwell*, 576 U.S. 473 (2015)
  - Chief Justice Roberts: “I don’t like broccoli!” BUT
  - “What’s in a name? That which we call a [tax] by any other name would smell as sweet...”
- Congress amends the ACA (2017): “Eat your broccoli – *please...?*”



# ACA Supreme Court Arguments – Renewed Challenges to the ACA

- States: “It’s not a tax and it doesn’t smell sweet”
- The Lawyerly Mess
  - Standing – who gets to sue?
  - The merits – what’s the scope of Congress’ power?
  - Severability – how much of the statute survives?



# ACA Supreme Court Arguments – Reading the Tea Leaves

- This Could Take A While... (because of the lawyerly mess)
- Standing – who knows??
  - States
  - Individuals
- The Merits – a chance for the conservatives to flex?
  - Justice Kavanaugh: “On the merits, the mandate as currently structured seems difficult to justify under the taxing clause for the simple reason that it does not raise revenue, among others.”



# ACA Supreme Court Arguments – Reading the Tea Leaves (cont.)

- Severability
  - Chief Justice Roberts: “I tend to agree with you that this is a very straightforward case for severability under the precedents, meaning that we would excise the mandate and leave the rest of the act in place.”
  - Justice Kavanaugh: “I think it’s hard for you to argue that Congress intended the entire act to fall if the mandate were struck down when the same Congress that lowered the penalty to zero did not even try to repeal the rest of the act.”

# Government Affairs Outlook – Lay of the Land



“You campaign in poetry, you govern in prose.”

Governor Mario Cuomo



# Government Affairs Outlook – Blue Wave Fails to Materialize

## Pre-Election

Healthcare (beyond COVID) A Significant Priority

Majorities in House and Senate Give Space To Act

Public Option on ACA Exchanges

Reform the ACA/Drug Prices

Medicare Eligibility Expansion

## Post-Election

COVID-19 pandemic worsening – but vaccine on the horizon

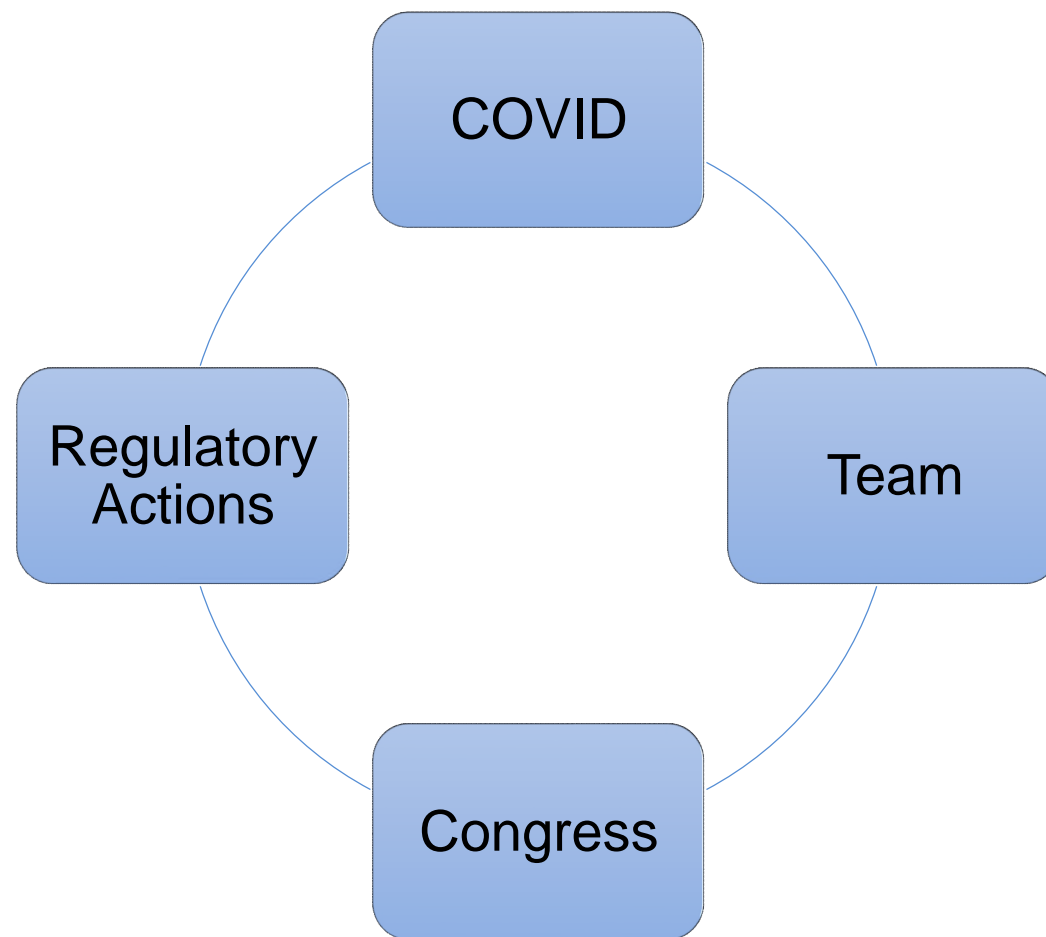
House majority smallest in 50 years

Control of the Senate Unclear

What Can Get Accomplished?

Biden's Default – Incrementalism and Compromise

# Government Affairs Outlook – What Will 2021 Look Like





# Government Affairs Outlook – Congressional Things To Do List (As of Dec. 4)

- FY 2021 Funding for Government – December 11
- COVID Relief Package (?)
- Healthcare/Tax Extenders
- Surprise Billing
- Drug Prices (?)
- Transparency (?)

# Capital Markets Themes for Healthcare Finance in 2020

## Credit

- All 3 rating agencies moved healthcare industry outlook from stable to negative as the COVID-19 pandemic hit the U.S.
- Bank lines of credit along with federal funding through the CARES Act and other programs helped bolster liquidity

## Product

- Market dynamics of public and private access to capital
- Increased use of put bonds, bond insurance, derivatives and other tools

## Price

- Muni market dislocation in March
- Credit spreads widened significantly and then narrowed again for AA credits

# Rating Agency FY2019 Median Snapshot

## MOODY'S

September 9, 2020

- Margins in the not-for-profit and public healthcare sector remained stable in 2019, suggesting most providers went into the pandemic with solid cash flow and liquidity levels
- Strong growth in outpatient volumes continued to offset low growth in admissions; expense growth outpaced revenue growth; margins remained stable but below historical peak in 2015
- Leverage metrics and liquidity improved in part because of strong market returns

## S&P Global

August 19, 2020

- Many operating metric trends have been generally stable since 2017 while balance sheets have mostly improved, providing a nice cushion for pandemic related challenges
- With industry pressures including the pandemic, the pace of unfavorable outlooks dramatically accelerated during Q2 2020
- 2021 median profile (FY2020) expected to be quite different with significant weakness in financial performance and balance sheets resulting from the pandemic and associated recession

## FitchRatings

September 1, 2020

- 2020 medians largely show improvements in operating margins and balance sheet strength
- Credit strength was at all-time high leading into the coronavirus pandemic in 2020, enabling the sector to weather the first half of the year better than expected
- In near future, multiple dynamics are at play, including longer term margin compression due to an expected weaker payor mix; additional expenses (PP&E) may become part of the permanent landscape

### Sources:

- Moody's: "Medians - Financial performance showed stability before pandemic", September 9, 2020
- S&P: "U.S. Not-For-Profit Acute Health Care 2019 Medians Show Stability While Recent Rating Actions Signal Weakening Ahead", August 19, 2020
- Fitch: "2020 Median Ratios", September 1, 2020



# 2020 Capital Markets “Tools & Trends”

Public vs. Private

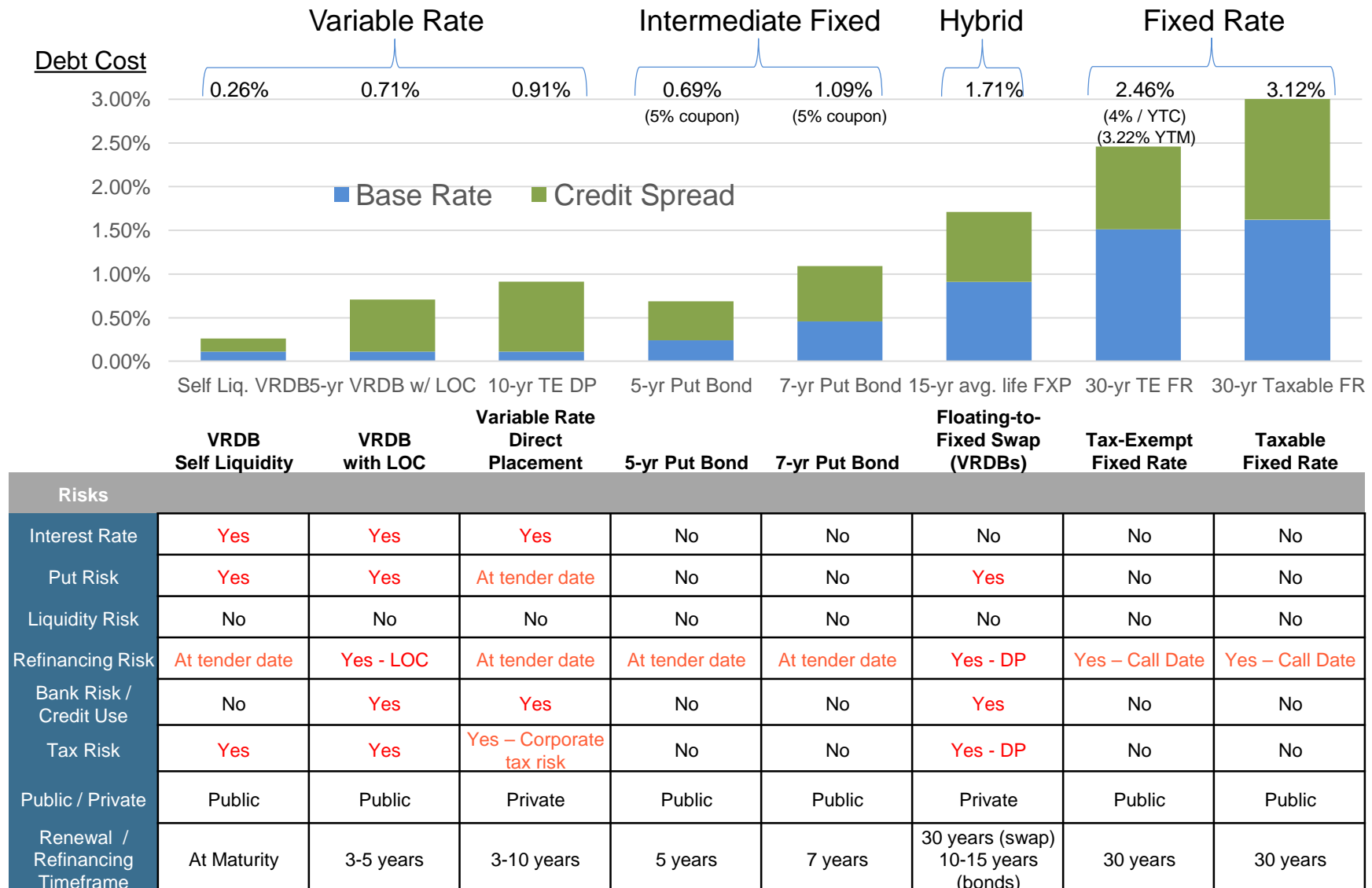
Fixed vs. Variable

Taxable vs. Tax-Exempt

Natural vs. Synthetic (interest rate swaps)

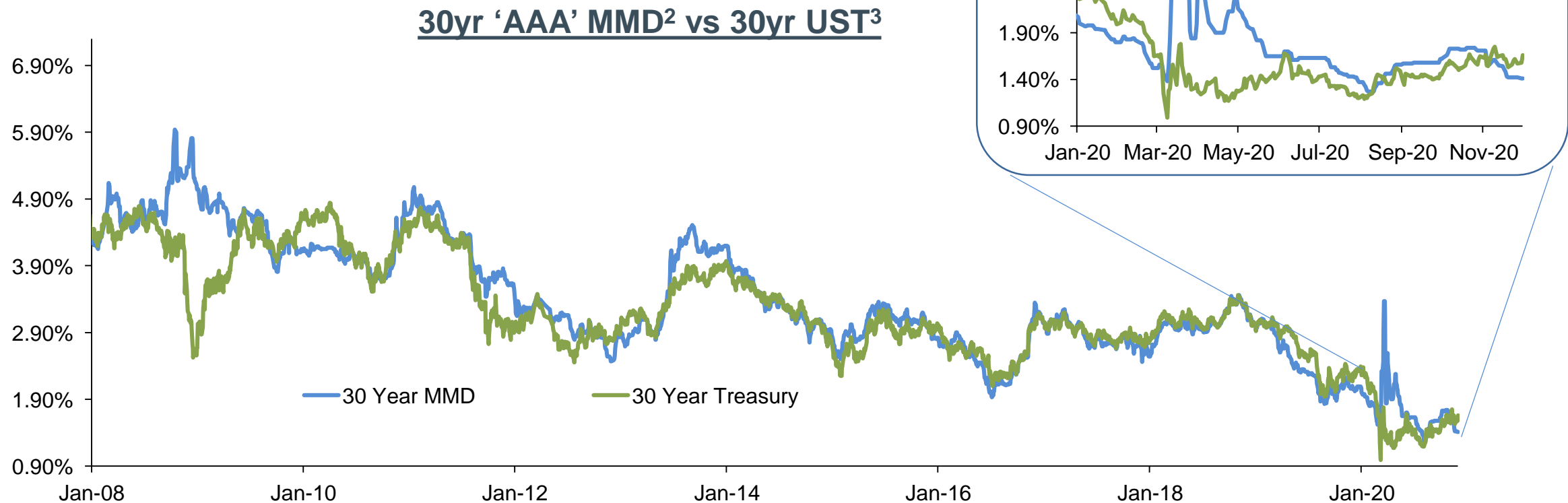
Use of credit enhancement (bond insurance)

# Debt Product Tools: Cost vs. Risk + Diversification



Note: Rates estimated as of mid-November for a double A healthcare credit; assumes SIFMA of 0.11%.

# Historical Interest Rate Overview

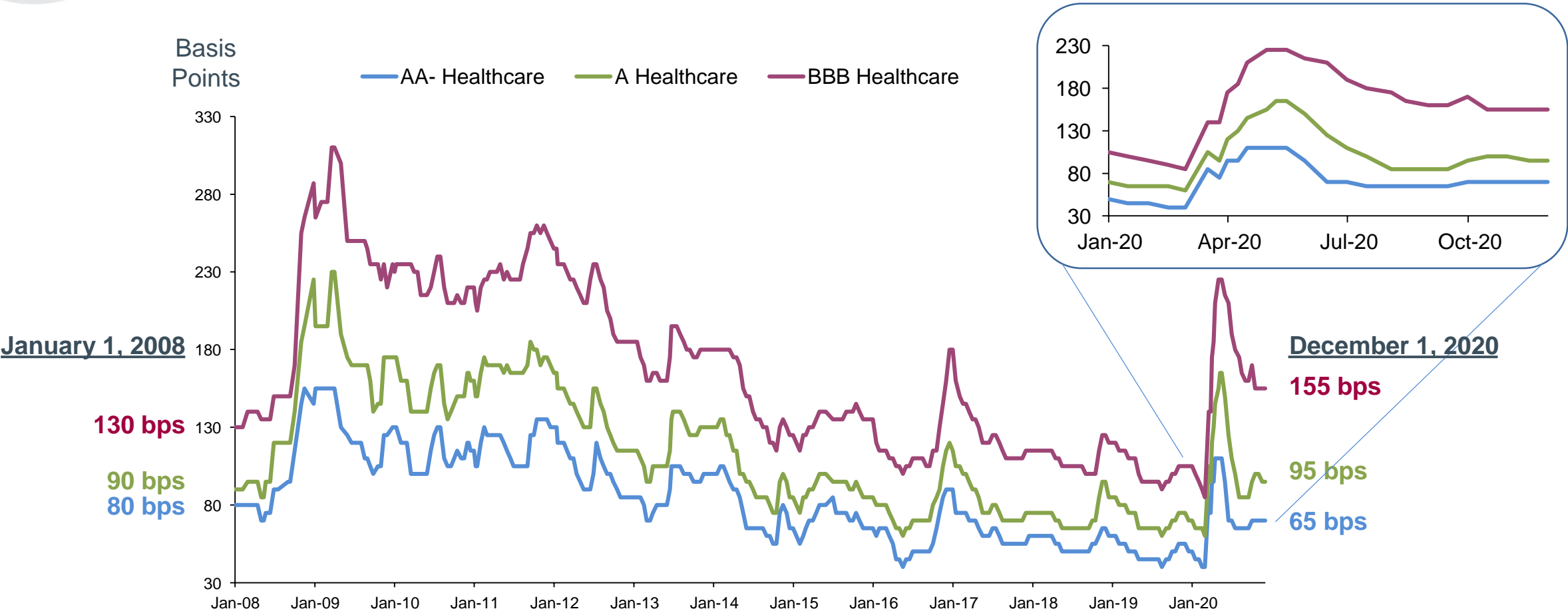


1. Rate history, January 1, 2008 through December 1, 2020

2. MMD rates are estimates and do not reflect actual traded levels. MMD is the Municipal Market Data index based on “AAA” rated General Obligations (“GO”) bonds. A GO is a common type of municipal bond that is secured by a state or local government's pledge to use available resources, including tax revenues, to repay bond holders.

3. The 30-year Treasury is a U.S. Treasury debt obligation rated “AAA” that has a maturity of 30 years. The 30-year Treasury used to be the bellwether U.S. bond.

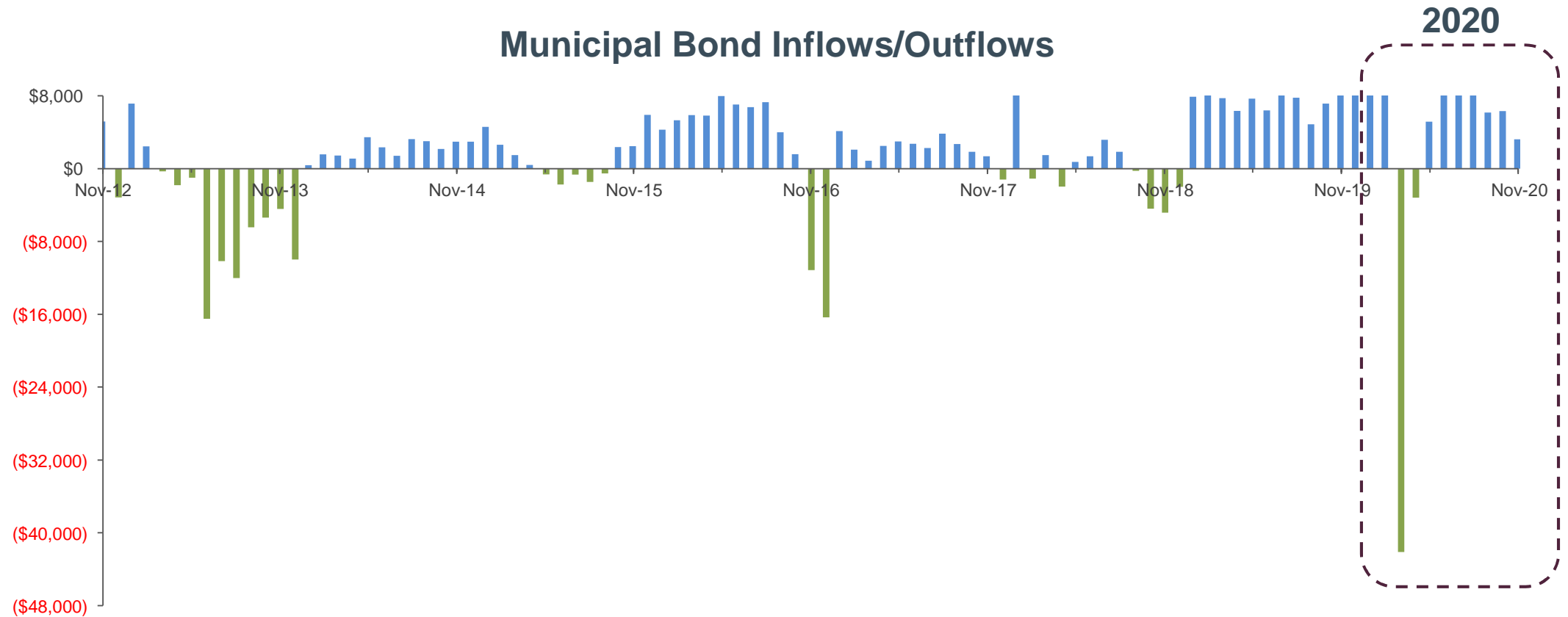
# Healthcare 30-year Tax-Exempt Credit Spread History



Source: Ponder & Co.; Rate history January 1, 2008 through December 1, 2020

# Municipal Bond Fund Inflows/Outflows

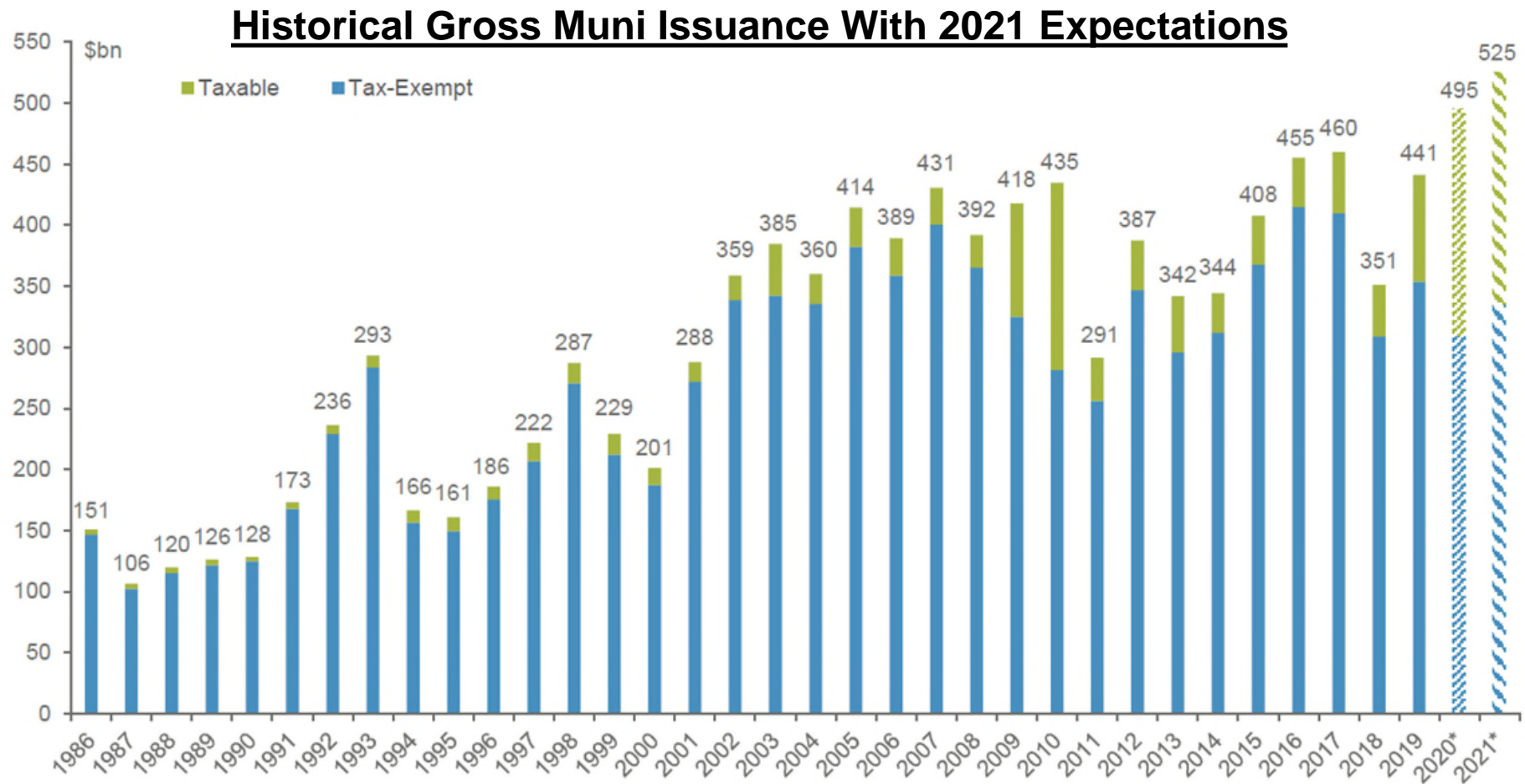
The municipal market is highly susceptible to supply/demand imbalances and key economic and political events, as illustrated in March 2020



Source: Preliminary data from Investment Company Institute ("ICI"). Numbers in millions.

# Overall Municipal Gross Issuance Trends

2021 expected issuance to exceed 2020 and previous 5-year average



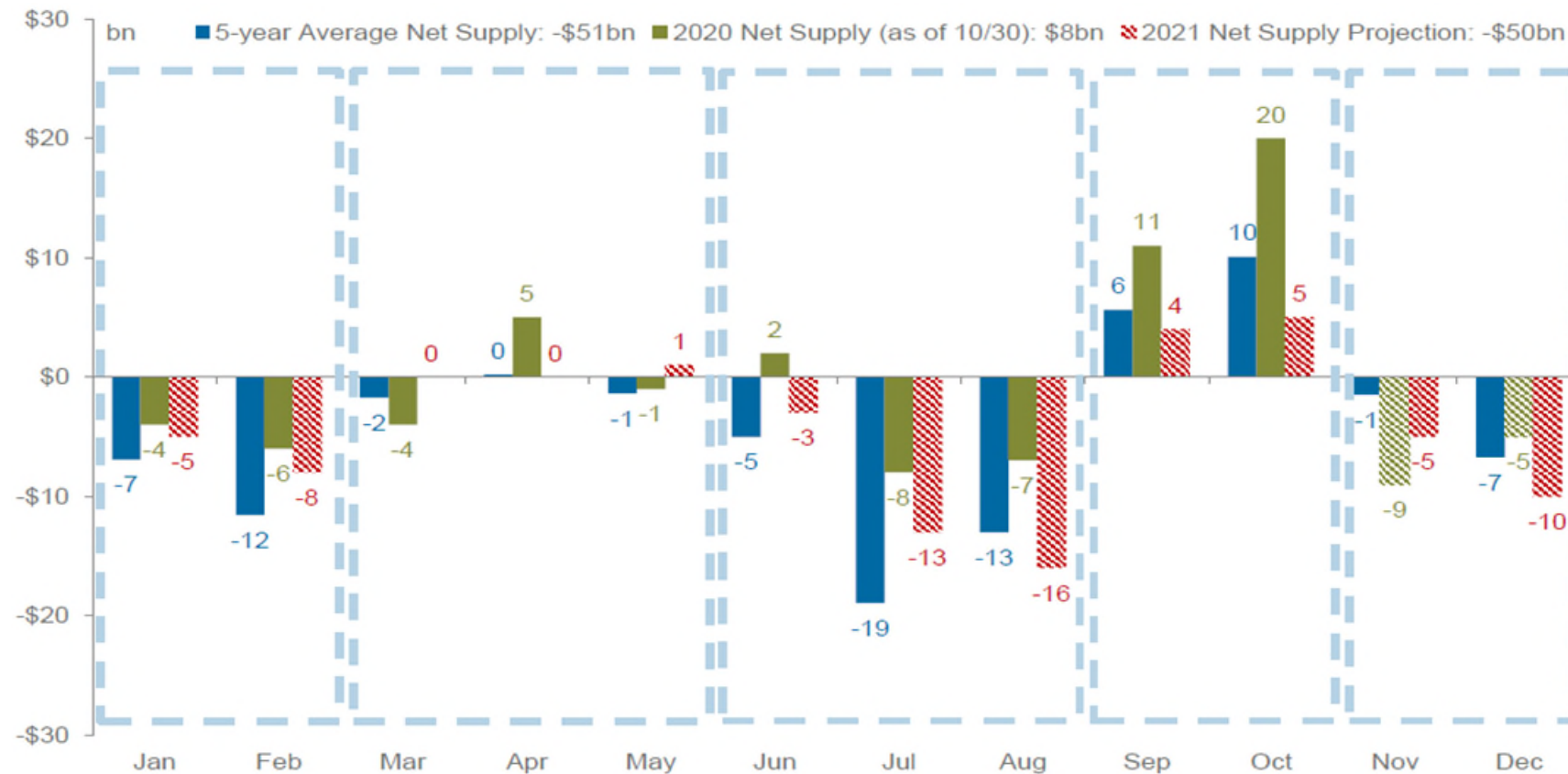
Source: JPMorgan weekly market update report dated December 7, 2020

\* Expected Issuance

# Monthly Municipal Net Supply

2021 net supply is forecasted to be -\$50bn, improved from 2020 and in line with 5-year average

## 5-year Average vs 2020 and Expected 2021 Supply



Source: JPMorgan weekly market update report dated November 30, 2020

# Taxable and Tax-Exempt Healthcare Volume<sup>1</sup>

2020 taxable issuance is up 152% YTD compared to 2019

- Total issuance in 2020 is up 33% through November, though tax-exempt issuance is down 24%
- Taxable issuance accounts for 61% of the total volume of healthcare issuance so far in 2020, compared to 32% in 2019

| 2020 Issuance Statistics (Through 11/30) |             |                   |                     |                |
|--|-------------|-------------------|---------------------|----------------|
|  | # of Issues | % of Total Issues | Par Amount (\$000s) | % of Total Par |
| Tax-Exempt                               | 114         | 58%               | \$18,059,735        | 39%            |
| Taxable                                  | 82          | 42%               | \$28,533,452        | 61%            |
| Total:                                   | 196         | 100%              | \$46,593,187        | 100%           |

| 2019 Issuance Statistics (Through 11/30) |             |                   |                     |                |
|--|-------------|-------------------|---------------------|----------------|
|  | # of Issues | % of Total Issues | Par Amount (\$000s) | % of Total Par |
| Tax-Exempt                               | 148         | 84%               | \$23,834,645        | 68%            |
| Taxable                                  | 29          | 16%               | \$11,301,546        | 32%            |
| Total:                                   | 177         | 100%              | \$35,136,191        | 100%           |

| YTD Change Through 11/30 |             |                   |                     |                |
|--------------------------|-------------|-------------------|---------------------|----------------|
|                          | # of Issues | % of Total Issues | Par Amount (\$000s) | % of Total Par |
| Tax-Exempt               | -23%        | -30%              | -24%                | -43%           |
| Taxable                  | 183%        | 155%              | 152%                | 90%            |
| Total:                   | 11%         | 0%                | 33%                 | 0%             |

| 2019 Issuance Statistics (Full Year) |             |                   |                     |                |
|--------------------------------------|-------------|-------------------|---------------------|----------------|
|                                      | # of Issues | % of Total Issues | Par Amount (\$000s) | % of Total Par |
| Tax-Exempt                           | 157         | 81%               | \$24,818,110        | 65%            |
| Taxable                              | 36          | 19%               | \$13,397,401        | 35%            |
| Total:                               | 193         | 100%              | \$38,215,511        | 100%           |

Source: Ponder & Co.

1. Volume statistics reflect only public fixed rate bond issues; taxable statistics reflect both corporate and muni cusip issues



## Other Options for Capital Access

Strategic Affiliations

Mergers & Acquisitions

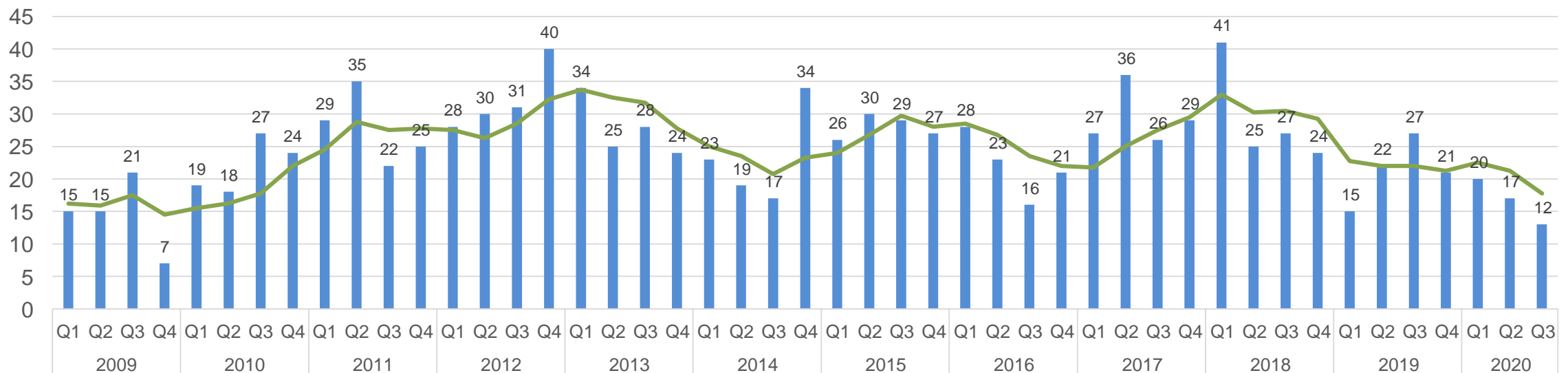
Sale of Non-Core Assets

Other

# M&A Activity Update

Transaction announcements declined in 2019 and 2020 following two years of significant volume

Number of Announced Hospital Change of Control Transactions  
2009 – Q3 2020



58

88

111

129

111

93

112

88

118

117

85

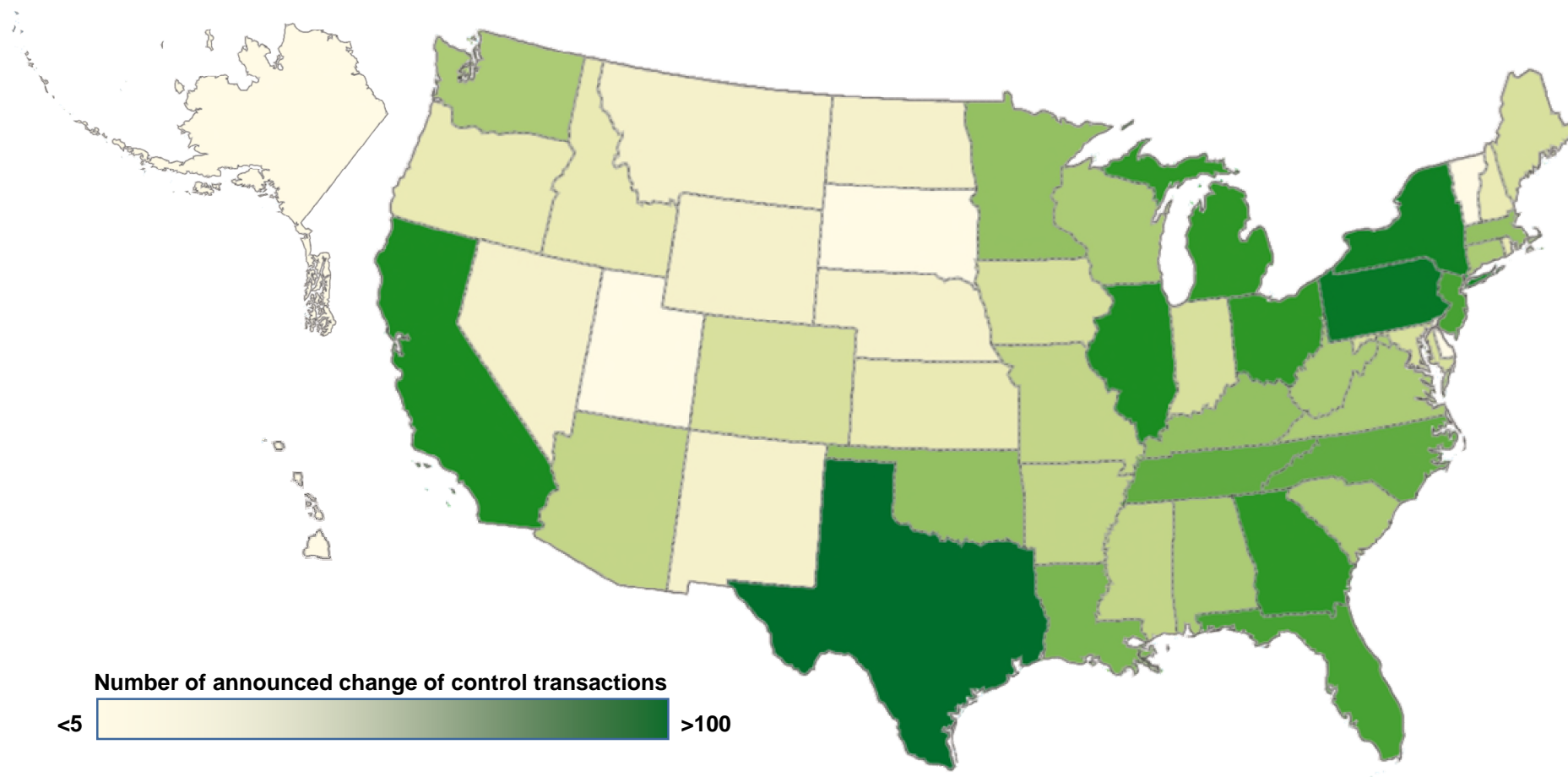
Number of hospital transactions

Rolling quarterly average for trailing twelve months

Source: Ponder & Co. internal database of announced acute care hospital change of control transactions

# M&A Activity Update

Announced M&A Activity by State, 2009 to Q3 2020



Source: Ponder & Co. internal database of announced short-term acute care hospital change of control transactions

# M&A Activity Update

## Q3 2020

| Date Announced | Target   | State | Target Tax Status | Acquirer                             | Acquirer Tax Status | Target Beds | Total Revenue (\$ MMs) |
|----------------|--|-------|-------------------|--------------------------------------|---------------------|-------------|------------------------|
| 07/03/20       | St. Luke's Hospital  | OH    | NFP               | McLaren Health Care                  | NFP                 | 312         | 176.2                  |
| 07/08/20       | Rennova Health (51% majority interest)                         | TN    | FP                | Private Individual                   | FP                  | 79          | 17.0                   |
| 07/14/20       | Wyoming Medical Center   | WY    | NFP               | Banner Health                        | NFP                 | 217         | 253.6                  |
| 07/17/20       | Huntington Hospital  | CA    | NFP               | Cedars-Sinai Health System           | NFP                 | 625         | 680.6                  |
| 07/24/20       | Stonewall Jackson Hospital (20% remaining interest)            | VA    | NFP               | Carrilion Clinic                     | NFP                 | 25          | 39.0                   |
| 08/25/20       | Yavapai Regional Medical Centers                               | AZ    | NFP               | CommonSpirit Health                  | NFP                 | 206         | 410.1                  |
| 09/02/20       | Murray Medical Center (AdventHealth long-term lease)           | GA    | NFP               | AdventHealth                         | NFP                 | 25          | 21.2                   |
| 09/08/20       | Lea Regional Medical Center                                    | NM    | NFP               | Covenant Health                      | NFP                 | 99          | 50.1                   |
| 09/10/20       | St. Peter's Healthcare System                                  | NJ    | NFP               | RWJBarnabas                          | NFP                 | 416         | 502.2                  |
| 09/24/20       | Harrington Healthcare  | MA    | NFP               | UMass Memorial Health Care           | NFP                 | 119         | 137.0                  |
| 09/30/20       | Two TN Hospitals (CHS)   | TN    | FP                | Vanderbilt University Medical Center | NFP                 | 118         | 92.6                   |
| 09/30/20       | Tennova Healthcare - Clarksville (CHS) (20% minority interest) | TN    | FP                | Vanderbilt University Medical Center | NFP                 | 234         | 162.4                  |

Source: Ponder & Co. internal database of announced acute care hospital change of control transactions; target revenue estimated from most recent cost reports



# Asset Monetization Strategies for Uncertain 2021

- Asset monetization strategies as a financial flexibility tool for healthcare providers to consider
  - Can be a response to challenging financial situation
  - Can be part of an overall asset/balance sheet management plan
  - Basic overview



# Asset Monetization Strategies for Uncertain 2021

- Which assets?
  - Non-core assets and/or discrete services such as parking facilities, central plant, off campus clinics
  - Additional considerations if assets were financed with tax-exempt bonds



# Asset Monetization Strategies for Uncertain 2021

- Key Elements of Most Asset Monetization Transactions
  - Healthcare provider receives upfront payment of unrestricted cash
  - Healthcare provider mitigates or eliminates the risks and responsibilities of asset ownership allowing for more time and attention on core mission of serving communities
    - ❖ Management responsibility.
    - ❖ Demand risk.
    - ❖ Costs of maintenance, renewal and repair
    - ❖ Long-term capital investment
    - ❖ Technology innovation risk



# Asset Monetization Strategies for Uncertain 2021

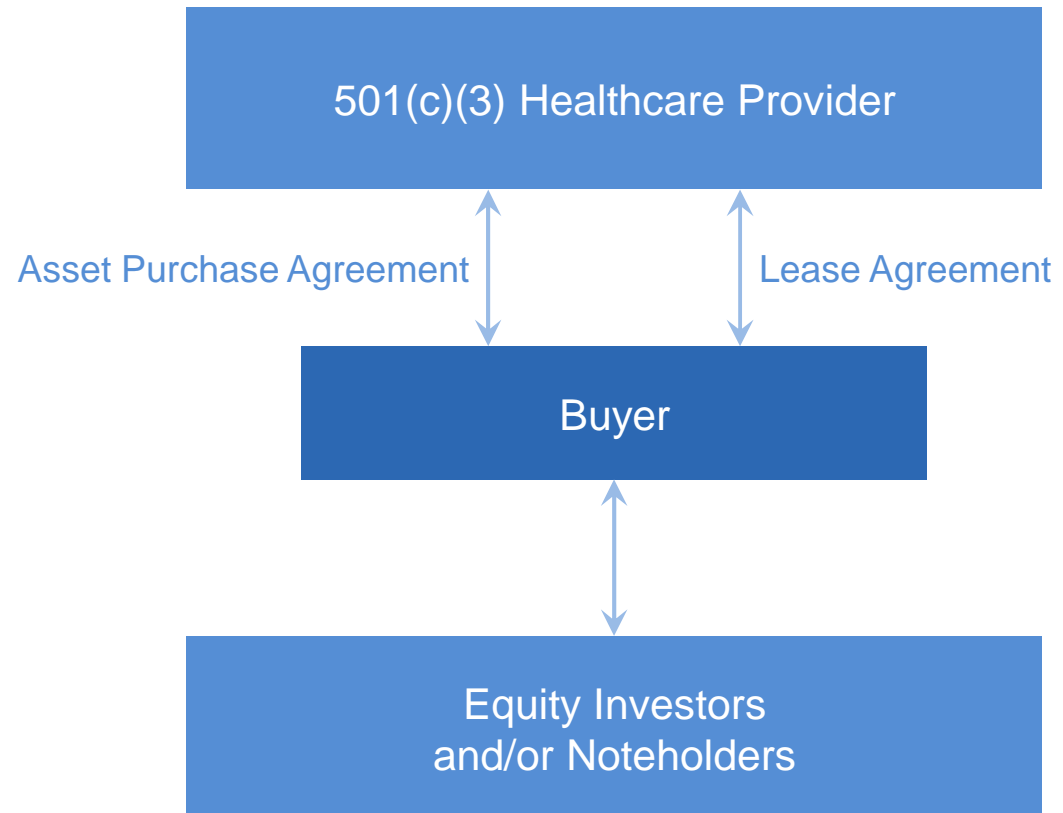
- Option: True asset sale
  - Just a monetization with no retained rights of ownership
  - Must lease-back assets to continue using
    - ❖ Key elements of lease-back arrangements
      - Term length and renewals
      - Exclusivity of use
      - Right to repurchase
      - Choose partner wisely



# Asset Monetization Strategies for Uncertain 2021

- Option: True asset sale (cont.)
  - Unless buyer is another c3 or governmental entity, buyer financing is not typically available on tax-exempt basis
  - REITs can often obtain financing on tax-advantaged basis which can lead to higher asset valuations

# True Sale/Leaseback Example





# Asset Monetization Strategies for Uncertain 2021

- Option: Concession transaction
  - Special purpose entity established to be concessionaire/operator
  - An upfront lump sum cash payment is made by the operator to the healthcare provider
  - Healthcare provider enters into long-term lease or similar agreement whereby operator agrees to accept many of the burdens typically associated with ownership. Risk-shifting provisions highly negotiated



# Asset Monetization Strategies for Uncertain 2021

- Option: Concession transaction (cont.)
  - In concession transaction, the asset returns to healthcare provider at end of agreement term; terms lengths of 50 plus years are common
    - ❖ Lengthy term allows concessionaire to focus on long term management of asset, including the financing of long-term capital expenditures.
    - ❖ Retained rights with respect to key decisions related to asset such as fee schedules and significant capital improvements.
    - ❖ Choose partner wisely.



# Asset Monetization Strategies for Uncertain 2021

- Option: Concession transaction (cont.)
  - Concessionaire agrees to fund all or significant portion of the ongoing costs of renewal, replacement and repair
  - Operator keeps all or a significant portion of the revenues generated by the assets
  - For central plant transactions, energy efficiency requirements can be incorporated into agreement



# Asset Monetization Strategies for Uncertain 2021

- Option: Concession transaction (cont.)
  - A healthcare provider's investment bank or other lender may be able to provide financing to operator at tax-advantaged rates
  - Tax-exempt financing might be available but comes with restrictions that will impact economics
  - New money concession transaction could be used to provide workforce housing



# Asset Monetization Strategies for Uncertain 2021

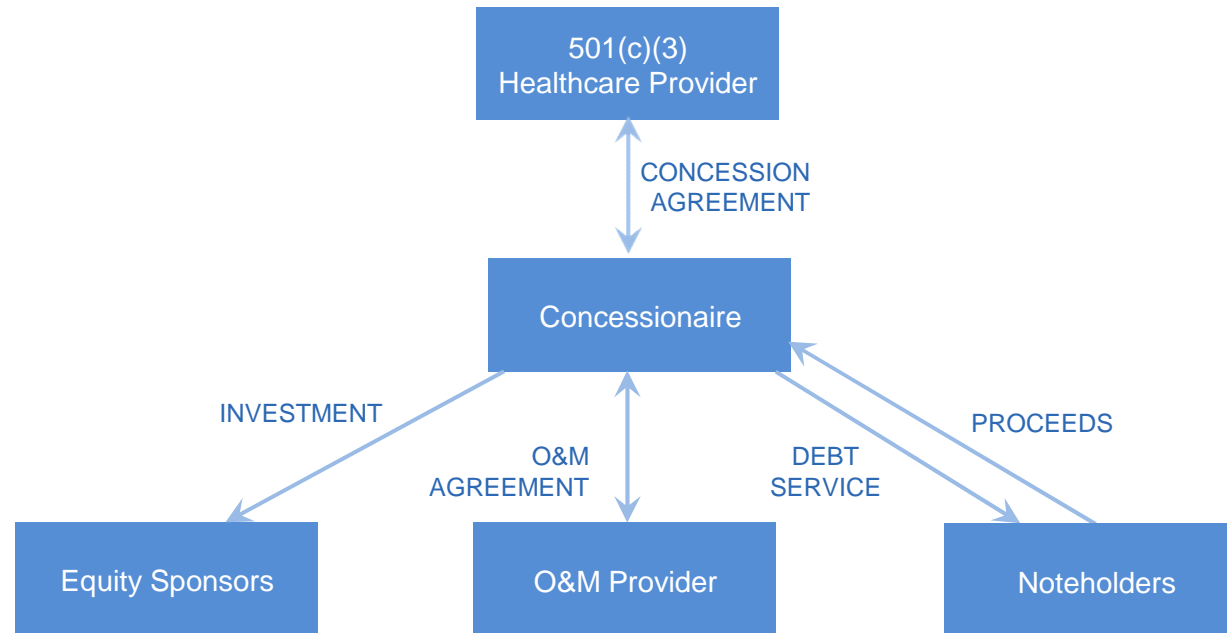
- For monetization transaction, consider compliance with existing bond and bank covenants
  - Disposition of assets test
  - Permitted lien test
  - How will proceeds of monetization be characterized for purposes of covenant compliance?
    - ❖ Days Cash on Hand
    - ❖ Debt Service Coverage
  - Change in use limitations
  - Are assets part of existing collateral package?



# Asset Monetization Strategies for Uncertain 2021

- For monetization transaction, consider compliance with existing bond and bank covenants (cont.)
  - Any continuing disclosure or other notice requirements?
  - Consider accounting treatment of transaction
  - Same or similar covenants to consider for M&A activity

# Concession Example





# Looking Forward

- The capital markets have adapted well to the current environment despite the pandemic
  - Market access is expected for most healthcare borrowers, both public and private
- New for 2021
  - Expected roll-out of COVID-19 vaccine
  - Biden Administration
  - US Treasury Policy
- Issues to watch
  - Emergency funds are being cut way back; how stable is the economy and healthcare organizations without them?
  - US Treasury stimulus funds made available to purchase muni bonds may be pulled back; what will be the impact for muni borrowers, lenders and investors?
  - With a polarized government, how will it affect the shaping of a tax plan?

Please note that this presentation is not intended, and should not be considered by anyone, to establish an attorney-client or other fiduciary relationship between presenters and attendees or readers. Today's speakers are not recommending any action to any municipal entity or obligated person, nor are they acting as an advisor to any such municipal entity or obligated person. They do not owe a fiduciary duty to any entity with respect to the information and material contained in this presentation, which is solely a general discussion of the topic. Any municipal entity or obligated person should discuss any information and material contained in or related to this presentation with any and all internal or external advisors and experts that such municipal entity or obligated person deems appropriate and should not take any action based on this presentation or related materials.