Recent Developments in Idaho Health Facilities Financing

Idaho Hospital Association Membership Meeting

Presented by:
John Sager, Idaho Health Facilities Authority
Mike Stoddard, Hawley Troxell Ennis & Hawley LLP

IHFA
Idaho Health Facilities Authority

HAWLEY TROXELL
ATTORNEYS AND COUNSELORS

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Idaho Health Facilities Authority: A Brief History

- The Idaho Health Facilities Authority mission is to assist eligible nonprofit health care providers to obtain and maintain access to low cost, tax-exempt private or public capital market financing.
- Established in 1972. Issuing debt on behalf of Idaho health care entities, both public and private, statewide since 1975. During this time, the Authority has never had a default.
- Authority Test Case – Idaho Supreme Court established the constitutionality of lease/leaseback structure for debt issuance on behalf of public hospitals in 1975 (so long as underlying hospital debt is authorized).

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Idaho Health Facilities Authority: Financing Process

- Application. No formal application required – just contact the Authority
- Financing Process. Contacting the Authority begins the process of evaluating financial feasibility, negotiating loan terms and drafting legal documents. The Authority has a team in place ready to assist the Authority and the borrower through this process.
- Post-issuance Monitoring. The health institution must meet certain rate and financial covenants throughout the life of the loan. In addition, the Authority offers post-issuance compliance assistance to assist the Borrower with continuing to satisfy tax requirements to ensure tax-exempt status of the obligation.

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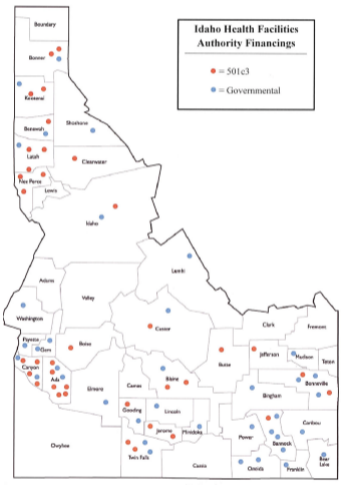
Financing Map



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Idaho Health Facilities Authority: Overview – Capital Markets

- **Conduit Issuer**: The Authority does not directly lend money. Rather the Authority indirectly provides money from third parties—such as banks or public bond markets—to the borrowing health provider entity.
- The Authority's ability to assist borrowing health providers is limited by the realities of the financial marketplace, and the availability of third-party lenders.

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Two-Minute Overview of Health Facilities Financing In Idaho

- Structures and legal restrictions differ based on whether entity is a public entity (county hospital, hospital district) or private entity (i.e., a 501(c)(3)) entity).
- Private 501(c)(3) entities are not subject to state legal restrictions; however, complex tax regulations still apply in order to issue tax-exempt obligations.
- General obligation debt issued by public entities requires 2/3 vote, unless it is "ordinary and necessary."
- "Ordinary and necessary" exception is limited to expenditures that must be incurred urgently (within the current fiscal year).
- Constitutional Amendment to Section 3C of Article VIII, Section 3 now allows public hospitals to issue revenue bonds, provided that no tax revenues are pledged. Hospitals still must meet statutory requirements to issue debt.

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Article VIII, Section 3C

Provided that no ad valorem tax revenues shall be used for activities authorized by this section, public hospitals, ancillary to their operations and in furtherance of health care needs in their service areas, may: (i) *incur indebtedness or liability to purchase, contract, lease or construct or otherwise acquire facilities, equipment, technology and real property for health care operations as provided by law*; (ii) acquire, construct, install and equip facilities or projects to be financed for, or to be leased, sold or otherwise disposed of to persons, associations or corporations other than municipal corporations and may, in the manner prescribed by law, finance the costs thereof. . . . Any obligations incurred pursuant to this section shall be payable solely from charges, rents or payments derived from the existing facilities and the facilities or projects financed thereby and shall not be secured by the full faith and credit or the taxing power of the county, hospital taxing district, the state, or any other political subdivision…

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County Hospitals: Statutory Authority to Issue Debt

- County hospitals' statutory structure is convoluted.
- County owns the hospital property; Board operates the hospital.
- Long-term debt of County hospital must be obligation of County rather than the Board. Board has no power to incur long-term debt. Idaho Code Section 31-3607(d) provides that the hospital board "shall not have the power to create any indebtedness in excess of the amount of its annual budget."
- Counties may lease County hospital property to the Idaho Health Facilities Authority for up to 99-years; there is no express statutory authority for long-term financing without the Authority.
- Note re Short-Term Debt: Per Idaho Code Section 31-3614, the Board may issue short-term "tax anticipation notes" directly, without using the Authority.

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Hospital Districts: Statutory Authority to Issue Debt

- Recent amendments to Hospital District statutes allow Hospital Districts to issue revenue debt without an election.
- Per Idaho Code Section 13-1339(2), no election is required for any lease or other transaction entered into between a Hospital District and the Authority, even if tax revenues are pledged and the amount exceeds $500,000. However, Article VIII, Section 3 election requirements would apply if tax revenues are pledged.
- The Authority financing structure is the same lease/leaseback structure used for County Hospitals.

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Authority Financing Structure: Public Hospitals

County Hospitals and Hospital Districts may finance through the Authority using a lease/leaseback structure:

- **Primary Lease**: The County or District enters into a primary lease with the Authority, whereby the County/District leases the existing hospital property to the Authority.
- **Bonds/Note Sale**: The Authority issues bonds to bondholders or sells a note in a private placement to a lender, in order to fund the loan to the hospital.
- **Lease Agreement**: The Authority, County, and Board (or the Authority and the District) enter into a lease agreement wherein the Authority subleases back existing facilities and leases improvements and equipment to the County/District. The County/District agrees to pay rent to the Authority in an amount sufficient to pay back bondholders or the private placement lender.

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Non-profit Hospitals

- Because they are not subject to constitutional and statutory debt restrictions, non-profit hospitals have complete flexibility to issue taxable debt, and may borrow on a tax-exempt basis through the Authority.
- There are numerous tax regulations and requirements that must be complied with prior to and following the issuance of the tax-exempt obligations, some of which are in addition to those rules applicable to public entity's tax-exempt bonds, such as public approval requirements, and TEFRA hearings.

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Market Access and The Changing Healthcare Landscape

- Dramatic changes in the U.S. Health Care system help to create uncertainties, which have made lenders more wary of providing credit to health care providers.
- Federal, state, and local budget limitations exacerbate these uncertainties.
- Rating Agency opinions on the healthcare industry remain negative, despite some good market indicators.
- Tax Reform and Jobs Act of 2017 had a major impact on hospital finance using the tax-exempt municipal bond market.

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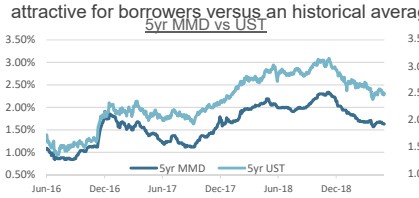
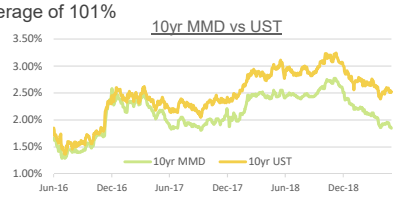
Historical Interest Rate Overview

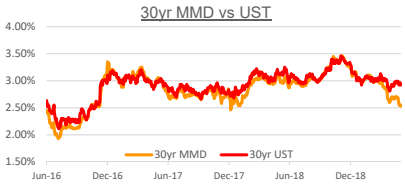
5, 10, and 30-Year 'AAA' Muni vs. Treasury Bonds June 2016-Present

Pre-tax reform MMD vs. UST rates show widening spread in short and intermediate terms (5 and 10 year rates) and a close relationship between 30yr rates

- Post-tax reform, rates trended upward for most of 2018, before declining approximately 40 bps to end 2018. Rates have declined an additional 49bps in 2019
- The relationship of MMD to UST decreased for both 5 and 10yr rates, but remained steady in the long end since December 2017. 30yr rate relationship has decreased recently to 87%, which is attractive for borrowers versus an historical average of 101%







Average Ratio of MMD/UST

	5yr Rates	10yr Rates	30yr Rates
Pre-Tax Reform	78.27%	90.68%	97.77%
Post-Tax Reform	73.27%	83.22%	97.41%

1. Rate history through May 1, 2019.
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.

Direct Placement Alternatives

Decrease in Corporate Tax Impact on the Private Placement Market

Sample Client DP Portfolio

Series	Par Outstanding	Bank Purchaser	Mandatory Put Date	Variable Rate Formula	Adjusted Formula	Comments
2010	$100,000,000	Bank A	4/23/2028	67% LIBOR + 79 bps	Unchanged	Early DPs may not have tax provision
2015	$92,325,000	Bank B	9/30/2022	67% LIBOR + 45bps	81.4% LIBOR + 55 bps	More recent DPs usually include the tax provision, but application varies.
2016A	$92,375,000	Bank B	3/1/2019	67% LIBOR + 30bps	81.4% LIBOR + 36 bps	
2016B	$98,300,000	Bank C	7/16/2025	67% LIBOR + 55 bps	81.4% LIBOR + 67 bps	

Impact of the decrease in corporate tax rate

Impact on cost post tax reform = ~1.215x original formula

Most modern Direct Placement ("DP") debt included a Margin Rate Factor that allows the bank to increase the interest cost of the facility if corporate tax rates decrease

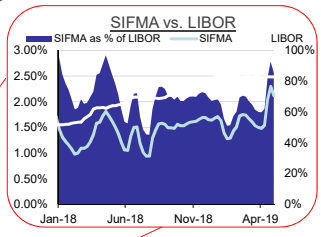
The higher interest cost formula forced health systems to look at alternatives:

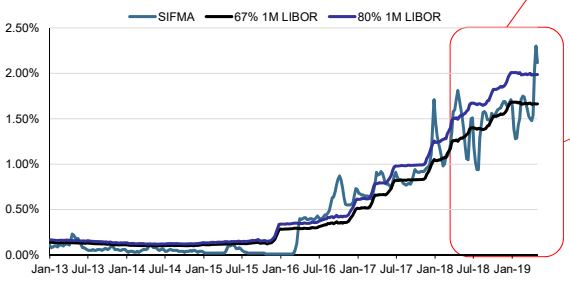
- Keep current structure and wait until the initial put date to act
- Renegotiate/ run a competitive RFP process – banks came back with the same higher ~80% 1mL, but decreased the fixed spread to try to compensate
- Convert to other debt products – Current trends have seen health systems consider SIFMA based product including FRNs and VRDBs as well as "semi-variable" put bonds
- Additional alternative to be considered is achieving SIFMA based DP through a basis swap

Short Term Rate Environment: the new SIFMA

Given significant changes in the short term market (MMF reform, change in corporate tax rates, etc.), the relationship between LIBOR based products (Direct Placements, FRNs, etc.) and SIFMA based products (VRDNs, FRNs, Commercial Paper) is in flux.

- Over time, SIFMA has returned closer to historical norms as it reached equilibrium based on marginal tax rates but volatility remains high
  - SIFMA has historically averaged 67% of 1M LIBOR
- With tax reform and 'increased cost language,' many existing and all new Direct Placements with higher spreads to LIBOR (80% vs. 67%) are underperforming SIFMA based products





Source: Thomson Reuters; Bloomberg.

Key Stats[1]	SIFMA[2]	LIBOR[3]	% LIBOR
5/1/2019	2.12%	2.48%	85%
1M Avg.	1.90%	2.48%	76%
12M Avg.	1.52%	2.28%	67%

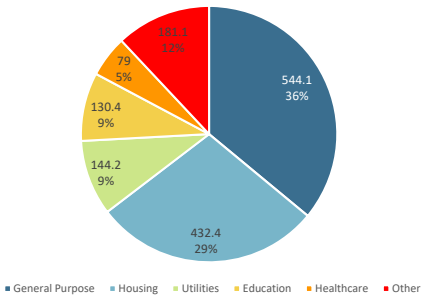
1. Data presented reflect interest rates and yields through May 1, 2019.
2. The SIFMA Municipal Swap index is a 7-day high-grade market index comprised of tax-exempt VRDOs reset rates that are reported to the Municipal Securities Rule Making Board's (MSRB's) SHORT reporting system.
3. LIBOR = London Interbank Offered Rate, is a short-term borrowing rate for banks lending funds to one another.

Private Placement Use – 1st Quarter 2019

1Q 2019 shows private placement bonds totaling $1.5 billion

- 2018 private placement issuance totaled over $16 billion, compared to 2017 issuance of nearly $26 billion
  - Post December 2017 tax reform the private placement market decreased significantly after increasing each year up to 2017
  - Private bank deals are no longer pricing as attractively for issuers and therefore they are moving to other variable products such as FRN's, VRDB's and Put Bonds

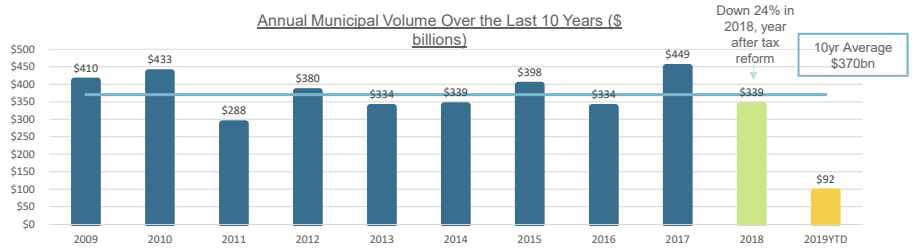
Private Placement Use – 1Q2019

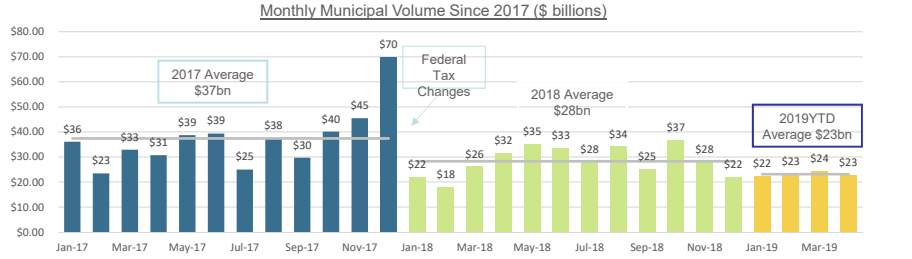


Source: Thompson Reuters Refinitiv

Municipal Supply

Supply decreased sharply at the beginning of 2018 compared to December 2017 when tax reform was announced. Issuance remained low in 2018 and 2019YTD





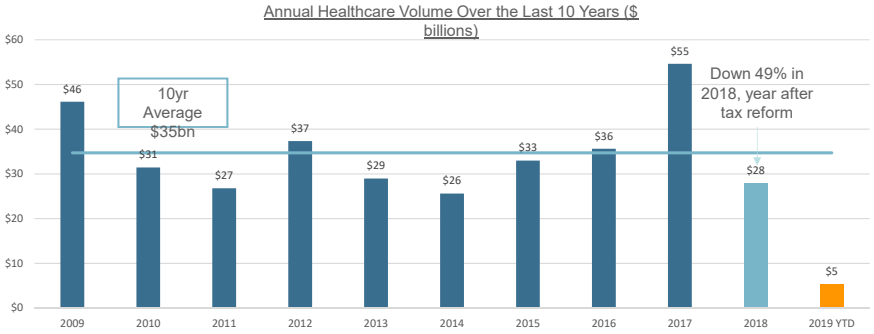
Source: Bond Buyer

Municipal Supply: Health Care

Healthcare supply decreased sharply in 2018 after the tax reform of December 2017. Supply remains low YTD2019

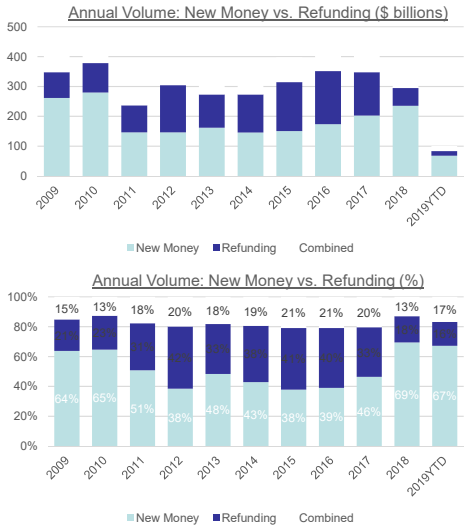
Healthcare issuance increased sharply at the end of 2017 when tax reform was announced, and decreased 49% in 2018, lower than the historical average

- YTD2019 issuance has been slow due to no advance refundings and lower capital projects but is expected to pick up from low levels



Source: Bond Buyer

Municipal Supply: New Money and Refunding Trends



New Money

- Declined significantly after 2008-2009 recession
- Has trended higher since 2014

Refundings

- Advance refundings went away after the tax reform in December 2017
  - Significant amount of advance refunding leading up to this date
- There are fewer tax exempt bonds eligible for refundings since the reform
- Continued authority for tax-exempt advance refundings of taxable bonds

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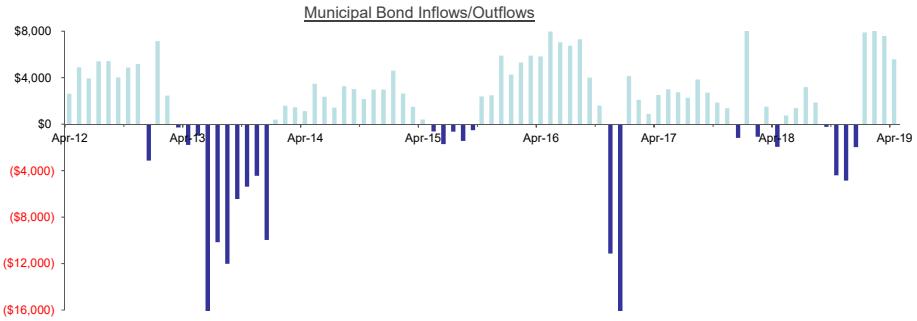
Source: Bond Buyer

Municipal Bond Fund Inflows/Outflows

April 2019 saw bond fund inflows of $3.6 billion, continuing the trend of positive inflows since January 2019

- Total inflows YTD are $31.9 billion; averaging $1.8 billion per week

Before the tax reform, bond funds were seeing consistent inflows. Inflows shot up in January 2018 after December 2017 but fluctuated through the rest of 2018



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

Access to Capital Markets: Public Offering

- Sale of bonds to the general public or a limited contingent thereof (i.e., qualified institutional buyers or qualified investors).
- Typically sold through an underwriting firm.
- Credit enhancement may be required.
- Typically offered through a negotiated sale.
- Rating by Rating Agency often required.

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Access to Capital is Strongly Influenced by Bond Ratings

Rating Agency opinions on the healthcare industry are still negative despite seeing some good indicators

S&P
- Improved margins due to cost cutting measures
- Volumes are still soft
- Improving liquidity due to investment performance rebounding

Moody's
- Aggressive cost-cutting measures offset lowest revenue growth period in 10-years
- Larger hospitals and systems showed greater improvement than smaller hospitals
- Modest growth in outpatient admissions offset flat inpatient admissions
- Slow economic recovery and high level of uncompensated care continue to put pressure on hospitals

As can be expected, more highly rated organizations ("AA" and "A") have access to more financial products than those with lower ratings ("BBB" and below)

- A stronger organization can diversify with fixed or variable rate bonds that incorporate different maturities, credit providers, and risk profile
  - Self liquidity for VRDBs
  - Put Bonds and Indexed Bonds
  - Higher bank capacity available for stronger credits
- BBB and under must rely on traditional fixed rate bonds or bank supported debt in the form of a Letter of Credit or Direct Loan
  - Only one potentially viable bond insurer available (Assured Guaranty)

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Access to Capital Markets: Private Placement/Direct Bank Purchase

- Negotiated directly with private investor or lender, such as a bank.
- Typically best for small issues.
- Terms and conditions negotiated directly with purchaser/lender.
- Although yield to purchaser is typically higher due to illiquidity, costs of issuance are typically much lower than in a public offering.
- Many banks offering this product ask for additional fee business as well.

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Direct Bank Purchase

Banks buying debt on either variable or fixed rate basis has become more popular

- Eliminates market put risk and exposure to a bank's credit profile
- Flexible terms and conditions
- Inexpensive to issue

Access for Borrowers

- Most banks offering this product are also asking for additional fee business
- Strong, large borrowers have access to more banks and more credit capacity than smaller hospitals since banks want to do additional business with larger hospitals
- Smaller hospitals have access to bank loans, however:
  - Primary banking relationship may be with a local bank
    - Unsophisticated with respect to hospital operations
    - Have asset lending mentality making it difficult to get the bank comfortable with a revenue bond approach
    - Have less lending capacity to meet the substantial needs of even a small hospital
  - If a regional or national bank is available, the bank may require all other banking services, displacing the existing relationship bank

Hidden Risks

- Banks commit for up to 10-years with a longer amortization
  - Debt service must fit definitions for smoothing in debt service coverage calculations
- Debt may become "current debt" on hospital books during final year of bank commitment
- Timing of default provisions can result in additional rating agency scrutiny with respect to liquidity

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Access to Capital Markets: Government Credit Support Options

USDA – rural development program financing for hospitals.

- Provides direct loans at attractive rates. Typically small loans of $2 million or less, although we are aware of at least one large ($44m) direct loan.
- Provides guaranty for taxable loan from bank. Taxable rates are higher than tax-exempt rate, but increased market access with federal guaranty and taxable obligations.
- Structural details may need to be modified/resolved with regard to structure for issuance under Idaho law.

FHA HUD 242 Program – financing for critical access hospitals.

- HUD has indicated a desire to expand the program across the country.
- Long lead time commitment and intensified credit analysis and due diligence procedure.
- Expensive to issue, with cost of issuance commonly in the 5%-6% range.
- The Authority has previously worked with HUD to successfully issue bonds on behalf of an Idaho hospital through this program.

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The Future for Idaho Tax-Exempt Debt for Healthcare

- There are lenders and underwriters willing to purchase Idaho hospital debt.
- Despite tax reform and market's view of healthcare as a riskier investment, credit spreads remain well below historical averages.
- Interest rates remain attractive and well below historical averages.
- Tax-exempt bond financing, while adding complexity, is still a non-profit hospital's lowest cost financing option.

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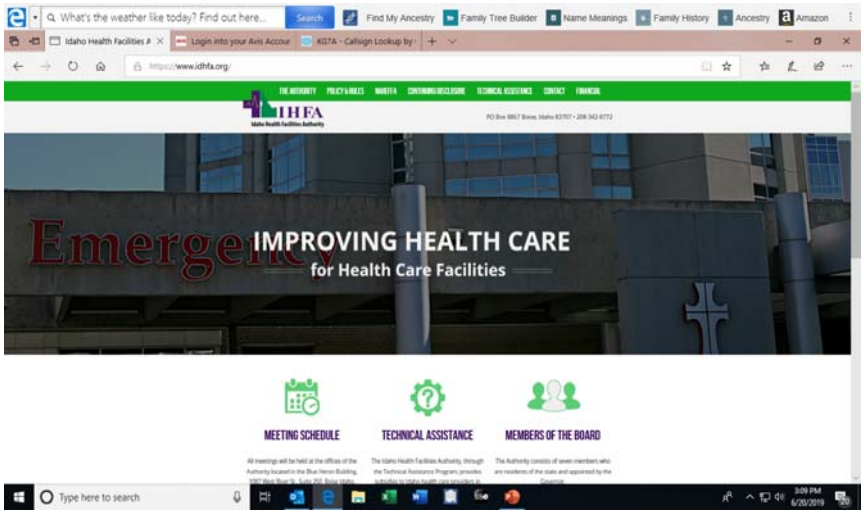

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