

Hospitals need corporate finance model

EXPERTS SAY HEALTHCARE SYSTEMS MUST HANDLE FINANCES LIKE BUSINESSES

By Murray W. Wolf

To succeed in the future, hospitals and health systems must adopt a corporate finance model when it comes to paying for renovated, expanded and new facilities.

FINANCING & INVESTMENT

That's according to a panel of experts who spoke during the Sept. 23 audio conference, "Bonds and Beyond: Current Trends and Fresh Strategies for Successful Healthcare Facilities Financing."

"Capital and strategies around capital are fundamental to success in the healthcare industry," according to James M. Moloney, a senior vice president with Cain Brothers & Co., a leading investment bank that focuses exclusively on healthcare. We are seeing "a paradigm shift in the way the healthcare industry views itself," he told the conference audience.

The Hospital Survey and Construction Act of 1946, sponsored by U.S. Senators Lister Hill and Harold Burton and commonly referred to as the Hill-Burton Act, set the stage for a municipal finance model for hospital financing, Mr. Moloney said. Hill-Burton provided federal money to assist with hospital improvements that had been deferred during the Great Depression and World War II. The advent of Medicare in the 1960s and tax-exempt financing in the 1970s reinforced the municipal finance model, he said.

But, the advent of Diagnosis Related Groups (DRGs) in the 1980s, the Prospective Payment System (PPS) in the 1990s and the Balanced Budget Act of 1997 changed the financial

picture, Mr. Moloney said. Those regulatory changes helped to expose the operating risks and earnings volatility of hospitals and health systems, which caused credit rating agencies to raise their standards.

Consequently, hospitals and health systems are trying to minimize the amount of non-core assets and debt they carry on their balance sheets, added William Roberson, a senior vice president and director of medical office properties for GE Healthcare Financial Services, a provider of capital and financial solutions for the healthcare market.

As part of that, hospitals are allowing third parties to develop new medical office buildings (MOBs) and to acquire their existing MOBs, Mr. Roberson explained. That's attracting new investment capital to the medical real estate market.

"Medical office is now an institutional grade asset class; blue chip" Mr. Roberson said.

From a borrower's perspective, "Cost of capital is probably one of the most important components of the structure," according to Bruce A. Rendina, Chairman and CEO of Rendina Cos., one of the nation's largest medical real estate developers, owners and property managers. With interest rates near historic lows, this is a good time for borrowers to act, he said.

"Now it's time to lock in that long-term fixed rate," Mr. Rendina said. For new construction, he said choosing the right development partner is essential.

"It's important that you choose somebody who has experience and a track record in medical facility development," he said. "That will help in the success of your financing."

Having long-term, triple-net leases is also advantageous, he said.

The move toward third-party development and ownership of MOBs comes at a time when healthcare providers face growing pressure to upgrade their facilities, added Jeffrey W. Land, vice president for corporate real estate at Catholic Healthcare West, California's largest not-for-profit health system.

"Without question, we have an unprecedented build-up in acute-care construction across the country," he said, "... and it doesn't show a lot of signs of softening in the next two or three years." That is posing a challenge for many providers.

"Cash flows ... often cannot keep up with our capital requirements," Mr. Land told the audience.

Although many hospitals and health systems are using off-balance sheet financing – especially third-party development and ownership of MOBs – rating agencies are beginning to raise questions about some of those deals, he cautioned. Even if a provider has no legal obligation regarding a third-party MOB, the provider might decide to step in if the deal goes sour, and some rating agencies are beginning to factor that in when calculating credit capacity.

"Bonds and Beyond: Current Trends and Fresh Strategies for Successful Healthcare Facilities Financing" was sponsored by GE Healthcare Financial Services, Rendina Cos. and Cain Brothers & Co., and was presented by **Healthcare Real Estate Insights™**.

A full 90-minute audio recording on CD and a complete set of presentation materials for this audio conference are still available. For details, please visit www.hreinsights.com. □