

# The Massachusetts Council of Community Hospitals Supports

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Senate 2368

An Act to Create A Community Hospital  
Capital Reserve Fund

# The need for affordable capital to support community medicine is significant

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- Community hospitals have been at a historic disadvantage in acquiring affordable capital, primarily due to low operating margins. There is no confidence, in my opinion, that community hospital margins will improve significantly enough to change the status quo.
- Most, if not all, hospital debt requires expensive bond insurance, among other credit enhancements, in order to reach the capital markets.
- We are expecting significant growth in the elderly population, requiring significant hospital expansion, yet expansion to date has only occurred in the more expensive teaching sector. With already over 50% of admissions being to a teaching model of care the imbalance will accelerate if the community hospital sector cannot grow proportionately.
- Unless community hospitals have access to the latest technologies that support non-tertiary care they will be at great risk in maintaining their documented high quality of care.

“The ability to cover long term debt obligations remained a serious concern for 25% of Massachusetts hospitals.” (Quarterly Acute Hospital Financial Report, FY07Q3, Massachusetts Division of Health Care Finance and Policy)

# **Support for S2368 reflects the recognition that the community hospital sector will need additional capital, which is likely to be substantial over time, and it should be acquired in the most cost effective manner as possible.**

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S2368 has support from:

- The Massachusetts Council of Community Hospitals
- Associated Industries of Massachusetts (A.I.M.)
- Blue Cross/Blue Shield of Massachusetts
- Massachusetts Association of Health Plans
- Massachusetts Hospital Association

# The “moral obligation” bond concept is an innovative approach to hospital financing that has the potential of improving access to capital and at the same time eliminating wasteful expenditures.

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- It is a proven concept in the state of Maine with over 100 bond issues since 1992. It is a common approach in state bond banks and single family housing.
- It does not represent a panacea for all hospitals or all situations. It is an option that creates an additional financing route in an era of increasing instability and likely higher costs.
- It has the potential for reducing the cost of bond insurance significantly, creating lower issuance cost, and allowing for lower rates of interest on the bonds. (It may lead to issue ratings the same or one notch lower than the state’s overall rating.)
- Our experience will likely not initially mirror the Maine experience since they have a long track record and have developed confidence and institutions that reinforce the relative safety of their bonds. Massachusetts has many of the same potential attributes that suggest a relatively rapid ramping up of equivalent supports to the program that should eventually optimize benefits.
- This should be a state budget neutral program. It should not have a significant bearing on the state’s bond rating and no bearing on its indebtedness.

# Operation of the Maine Program

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1. Bond proceeds are deposited with the Trustee Bank for the benefit of the bond holders.
2. Bond proceeds are subdivided into two accounts - the construction account and the capital reserve fund.
3. The borrower draws from the construction fund to complete the project.
4. The Capital Reserve Fund is determined to be one (1) years principal and interest (PI) at the highest PI over the life of the issue. The Fund is jointly controlled by the Authority and the Trustee Bank.
5. The Capital Reserve Fund is evaluated on a certain date annually for compliance with the minimum funding level.
6. If for whatever reason the borrower did not/would not make a required payment, the Authority would give permission, in the form of a written direction, to make a debt service payment.

- 7) If the Capital Reserve Fund requires replenishment at a certain date (e.g. Dec. 1) MHHEFA is required to notify the Governor of the specific deficiency and request legislation to allow for an appropriation to erase the deficiency.
- 8) The legislature is not obligated to honor this request. A “moral obligation” then exists.
- 9) In the event of a condition where the borrower is not planning to pay the bond holders the Authority can intercept Medicaid payments to accumulate funds to pay the deficiency.
- 10) In the event of default, and to the extent that other borrowers have contributed to this Capital Reserve Fund, the total Capital Reserve Fund is available to pay the deficiency. The other borrowers in the pool are not obligated on the outstanding debt of the defaulted borrowers.
- 11) The cash that would be deficient in the Capital Reserve Fund to cover the defaulted PI is recovered since the Authority would intervene to engage an organization to run the hospital, and/or to sell some or all its assets.

# Why have “moral obligation” bonds enjoyed historically favorable treatment in the capital markets?

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- It is all about confidence in the underlying credit coupled with the judicious use of state legislation, regulation and policy decisions.
- Historically the decades long use of such bonds nationally in the housing market have produced minimal, if not zero, defaults to date.
- In the instance of Maine, a long track record with significant understanding by the rating agencies of the concept.
- The increasing viability of the pool overall as better credits enter the pool that raise the overall credit rating of the pool.
- Pool features, such as a Medicaid intercept, that add to confidence of the bond holders that their investment has state protections built in.

# The opportunity to create a new model for affordable capital is high.

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- The meltdown of the sub prime market has damaged many investors and notably the bond insurers (AMBAC, MBIA, etc.). We can expect future bond insurance and other factors to conspire to make debt more expensive.
- While our underlying profitability is very poor, we have little if no excess capacity in the hospital system. This suggests that the credit hospital is needed and likely to be supported in the marketplace.
- We have in place regulatory vehicles, such as the Determination of Needs (DoN) Program, and strong licensure and oversight over quality of care that again supports an outsiders view that the credit hospitals are accountable. The Commonwealth has a track record of going to the aid of a distressed hospital.
- We have the possibility of enhancing the reserve pool with Medicaid and other government monies intercepts that further improve confidence.
- The Maine experience has educated the market and the learning curve for all the players should be relatively short.