THE BOND BUYER

Hospital Bankruptcies on the Rise, Firm Warns

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CHICAGO -- Hospital bankruptcies are on pace this year to set a record, according to a restructuring firm that monitors the sector.

The weakness spread throughout the sector should prompt investors to get more heavily involved in a hospital's restructuring, according to Evanston, Ill.-based SOLIC Capital Inc., an investment and distressed asset management advisory firm.

"Going into 2014 and through 2014, independent not-for-profit community hospitals are facing substantial headwinds and economic challenges related to the full rollout of the Affordable Care Act," Gregory Hagood, senior managing director and president of SOLIC said in a recent interview with The Bond Buyer.

The number of bankruptcies in the sector has hovered around 15 or less a year since 2009, except for 2013 when the figure ticked up to 19, according to the firm. But there have been 13 so far in the first two quarters of 2014, Hagood said.

Rural stand-alone hospitals in the northeast and southeast are particularly vulnerable, he said.

"Historically independent community hospitals have been very stable, heavy issuers of municipal debt," he said. "Over the last 12 to 24 months, we've seen a significant dropoff in new issuance volume from the sector and an acceleration of bankruptcies."

Much of the hardship can be tracked geographically, said Matthew Caine, managing director at the firm.

New York led the country in the number of filings, with 14 since 2009 through the first half of 2014. Texas is next, with 13, followed by Arizona, with nine, and California, with seven.

"Our view is that states predominately in the southwest are likely in the crosshairs with downward performance and compression of operating margins," Caine said. New York's hospitals are feeling squeezed by reimbursement pressures and competition, whereas big markets like Texas and California are also facing reimbursement pressures as well as weaker bottom lines.

As do ratings analysts and other market participants, SOLIC predicts that pressures will increase for hospitals located in states that have opted not to expand their Medicaid program under the new federal health care law.

"Those hospitals are likely poised for potential compression of reimbursement and continued uncompensated care growth, whereas states with expansion are already seeing a lift in reimbursement," said Caine.

All three of the major ratings agencies have a negative outlook on the non-profit health care sector, with analysts also warning of reimbursement pressures amid other challenges like low volume. Downgrades have outpaced upgrades for several years.

Investors who hold hospital paper, especially of struggling hospitals, should get more involved in a credit's effort to restructure or boost revenues, the men said.

Historically, master trust indentures have been "covenant-light," with just a few requirements, said Hagood. But that is starting to change.

"We're seeing and advising investors, particularly large institutional holders that have some influence over issuers, that when you see covenants tripped, you have to be proactive," Hagood said.

The issuers are also starting to work more with bondholders, added Caine.

"We're seeing the boards on the provider side also being more proactive," Caine said. "These boards are waking up to the realities of this declining reimbursement environment."

Issuance remains low.

The sector has averaged roughly 50 bond offerings a quarter over the last five years, according to the firm. There were only 20 in the fourth quarter of 2013, 15 in the first quarter of 2014, and 26 in the second quarter.

That trend is likely to continue as providers try to save cash and preserve ratings amid an uncertain environment, the men said.

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