

***Top Credit Risks for Hospitals***  
***Robin Fisher – VP Franklin Templeton Investments***  
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**1. Stagnant / Declining revenue growth**

- Declining inpatient volume – shift to outpatient & observation visits
- Declining lucrative elective procedures
- Rising bad debt expense
- Payer pressures - Medicare (federal budget deficit) / Medicaid (rate cuts and eligibility changes) / Commercial (can hospitals continue to shift costs?)

**2. Market presence and local economy**

- Competitive position, if the provider is not #1 or #2 in the market, is it truly needed?
- Is the local economy overly exposed to a singular industry?
- Rising unemployment
- Concentrated payer environment

**3. Consolidation – The strong appear to be getting stronger...**

- Who gets left behind?
- Are the board and management willing to entertain partnership/exit strategies?

**4. Funding Capital / Strategic Needs while preserving liquidity**

- IT initiatives / Electronic Medical Records
- Physician alignment initiatives, at what cost?
- Pension funding
- CA Seismic Mandates
- Weaker hospitals starved capital over the past few years – can they access the capital markets, and at what cost?

**5. Reform, Reform, Reform**

- Is management and the board preparing?
- Shift from fee for service reimbursement to value/quality based reimbursement
- Bundled payments / ACO's
- Disproportionate share cuts

**❖ *Given the implied risks, what needs to be incorporated in deals to achieve maximum investor participation?***

- Transparency
- Sound Governance & Management practices
- Best practices in disclosure - minimal compliance with 15c2-12 is not enough
  - a. Consolidating financial statements
  - b. Quarterly disclosure (all 4 quarters) within 45 days, Annual audit within 120 days
  - c. MD&A
  - d. ONGOING ACCESS to MANAGEMENT
- Covenants
  - a. Debt service reserve fund
  - b. Rate covenant with less than 1.0x debt service coverage an event of default
  - c. 1<sup>st</sup> mortgage liens
  - d. Liquidity covenant
  - e. No substitution of notes provision