

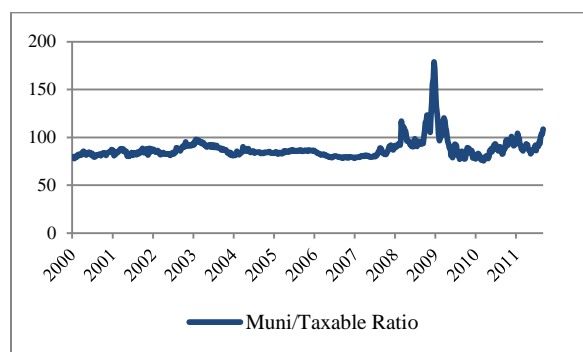
Market Turbulence Creates Financing Opportunity Government Program Offers Capital Market Access and Savings

On the evening of Friday, August 5th 2011, Standard & Poor's downgraded the credit rating of US government obligations citing fiscal policy and debt burden concerns as its primary rationale. Under normal circumstances, one might expect a credit downgrade to result in higher borrowing costs for the US government. Paradoxically, yields on 10-year treasuries which were 3.22% at the beginning of July dropped to as low as 2.07% in mid-August. The 10 year treasury then edged up to 2.23% by the end of August before diving again – this time below 2.00% by mid-September and has continued to trade in the 2.00% to 2.25% range.

So why does a downgrade of the world's largest borrower lead to lower treasury rates? Simply stated, US treasuries remain the most highly sought security in the world. Investors continue to value US treasuries as risk-free investments, while sovereign debt concerns among the world's other large economies and concerns regarding the global economy in general lead investors right back to US treasuries in a flight to *relative* quality.

The rapid decline in treasury yields, a global benchmark for many assets, has directly resulted in lower yields in the tax-exempt municipal market. However, the global demand for treasuries is so strong that it has all but eliminated the tax-advantages offered by highly rated municipal bonds. Granted, there are other factors affecting the relative value of municipal bonds versus treasuries including a well-known analyst's prognostications of weaknesses in the municipal market.

Tax-Exempt Rates as % of Taxable Rates



Source: Thomson Reuters Municipal Market Data

The flight to high quality assets has depressed the yield on US Treasury securities – and GNMA securities -- as investors seek refuge amid uncertain market conditions. ***Hospitals can now finance***

expansions or refinance their debt with GNMA securities at taxable interest rates that are often more favorable than tax-exempt bond fixed rates.

Hospitals obtaining FHA mortgage insurance under Sections 242 and 223(f) of the National Housing Act can utilize the issuance of GNMA pass-through certificates rated Aaa/AA+ based on the full faith and credit of the United States. Even with the cost of FHA mortgage insurance (50 basis points or 0.50% annually) and the additional servicing and GNMA fees (typically 25 basis points), a hospital's interest rate would still be substantially below rates available in the tax-exempt bond market for borrowers in the non-rated, BBB, A, and AA credit rating categories in many cases. As discussed below, even AA borrowers can find significant interest savings if they have large negative arbitrage during construction or if the additional debt would lower their credit rating.

Regulations are currently being finalized which will open a new opportunity for healthcare borrowers to refinance at these attractive rates. The following table illustrates approximate borrowing rates, including credit enhancement costs, based on recently issued debt.

Current Market Rates

FHA GNMA Refinance	AA	A	FHA GNMA New Money	BBB	Non Rated
4.20% to 4.50%	4.80% to 5.25%	5.25% to 5.50%	5.25% to 5.50%	5.75% to 6.75%	> 7.00%

*FHA loan maturities are 25 years plus the construction period, if applicable. AA, A, BBB and Non-Rated indicative rates are for 30 year fixed rate maturities. The interest rate is fixed.

Advantages other than the lower nominal rate may also exist. For a project involving lengthy construction, the absence of "negative arbitrage" can greatly reduce interest expense. Closing costs can be reduced without the need for extensive work by tax and bond counsel, as GNMA certificates are taxable and can be issued with standardized GNMA securities disclosures.

The FHA hospital program has historically been utilized by hospitals that would have difficulty accessing AA credit ratings. With GNMA securities at historically low rates, any hospital with outstanding, callable or soon to be callable debt should consider utilization of the FHA program and GNMA securities. Even hospitals with AA ratings may take advantage of the FHA and GNMA rates

should they have a sizable and lengthy construction project.

Negative Arbitrage

In a tax-exempt transaction, all bonds are issued at closing. Bond proceeds for construction are placed in a project escrow account and drawn upon as construction progresses. The bond proceeds held in escrow earn very low yields in the current interest rate environment. However, the borrower must still pay bondholders the full bond interest rate for all sums borrowed. This interest rate differential results in “negative arbitrage” on the escrowed construction fund that can be quite expensive.

By contrast, GNMA certificates can be sold in a forward purchase transaction that locks in a fixed interest rate while avoiding payment of interest until construction funds are disbursed. The GNMA issuer will enter into an agreement with one or more prospective investors. The investor(s) agree to purchase the GNMA certificates at a future date as funds are needed. The investor’s certificate bears an increased yield to compensate for the forward purchase commitment. While the yield will be higher than that of a GNMA used for refinancing purposes, the Hospital benefits greatly by borrowing funds only as construct progresses. This typically eliminates millions of dollars in negative arbitrage. The premium in GNMA yield on construction projects relative to refinance projects will vary depending upon market volatility, anticipated interest rate increases and the anticipated timing and duration of the construction project.

Structuring Alternatives

A hospital can also utilize taxable bonds secured by GNMA certificates.

- ***Privately placed GNMA collateralized taxable bonds***

- Although often limited to qualified institutional buyers and issued in high minimum denominations of \$100,000 or more, these securities may be offered to a wider market than is typical for GNMA certificates. The bond market may also offer greater transparency for issuers and borrowers.

- ***Publicly offered GNMA collateralized taxable bonds***

- These bonds may have lower minimum denominations, such as \$5,000, and be eligible for sale to individual investors. The wider initial and secondary markets for securities may result in lower cost for borrowers.

GNMA collateralized taxable bonds may be issued as corporate bonds (i.e. the borrower issues on its own behalf) or as taxable municipal securities when a non-profit elects to issue bonds through a conduit issuer. The latter approach may allow for state and local tax-exemption even though federal tax exemption is unavailable.



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