WEBINAR – COVID-19 RESOURCES

Hospitals, Capital, and Cash Flow Under COVID-19

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Disclaimer: To the best of our knowledge, these answers were correct at the time of publication. Given the fluid situation, and with rapidly changing new guidance issued daily, be aware that these answers may no longer apply. Please visit our COVID-19 hub frequently for the latest information, as we are working diligently to put forth the most relevant helpful guidance as it becomes available.

PONDER&CO | RTG | PYA

Introductions

Michael Ramey
Principal
PYA, P.C.
mramey@pyapc.com

Michael Honeycutt
Senior Vice President
Realty Trust Group
mhoneycutt@realtytrustgroup.com

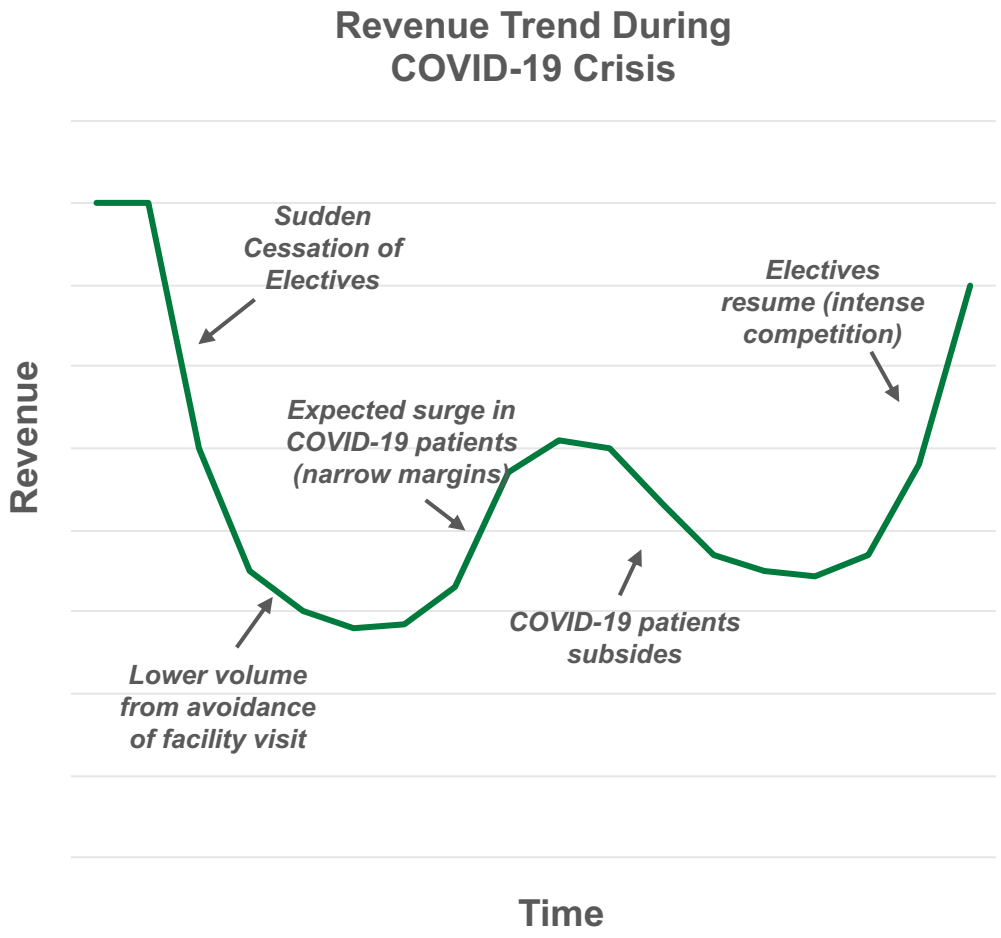
Jeffrey Sahrbeck
Managing Director
Ponder & Co.
jsahrbeck@ponderco.com

Topics of Discussion

- COVID-19 impact on hospital cash flow
- Sources of relief
- Impacts on:
  - Existing capital initiatives
  - Access to additional capital
  - Public fixed rate market
  - Healthcare credit spreads
  - Short-term market
  - Taxable municipal market
  - Debt covenants
- Real estate considerations
  - Capital considerations and strategies
  - REIT market
  - Immediate action plans
  - Long-term implications

Cash Flow Challenges

Roller Coaster Ride of Revenue



- **Outpatient volume** has decreased dramatically
- **Approximately 30%** of fee-for-service payments on Medicare inpatient claims are deemed elective
- Severe cash flow impact will be felt **45-50 days** after elective cessation
- **Collectability concerns** on existing patient portion of A/R given economic crisis
- **Looming competition** to capture pent-up demand and funding in aftermath of pandemic
- **Some electives will not return** due to loss in coverage caused by unemployment

Cash Flow Challenges

Moving forward, how do providers evaluate and prioritize efforts?

What are health systems doing to manage cash flow?

- Tone at the top: reducing executive salaries, deferring cash distributions and bonuses
- Appropriate use of existing lines of credit
- Evaluate temporary deferral of all non-essential capital purchases
- Evaluate force majeure clauses of contracts
- Investigate business interruption insurance policies for proceeds
- Manage supplies expense by leveraging “on GPO” products to protect against price increases
- Manage employee benefits funding such as timing of 401(k) matching, as specific plans allow
- Consider furloughing or reducing hours/compensation for non-COVID-19 focused staff
- Physician compensation adjustments
- Leverage telehealth services
- Pursue commercial payer advance payment programs
- Defer management fees
- Discuss rent abatement options as tenant
- Evaluate less liquid assets for potential monetization
- Proactively addressing impending debt covenant concerns

Sources of Relief

Federal Programs

- **Coronavirus Aid, Relief, and Economic Security ("CARES") Act**
  - **$100 billion** Public Health and Social Services Emergency Fund
    - Reimbursement for **health care related expenses or lost revenue** that are attributable to the coronavirus
    - **$1 billion** destined for testing and diagnosis of uninsured
    - CMS eluded to possible **initial tranche of $30 billion to be distributed soon** based on Medicare fee-for-service revenue; HHS has not issued any official direction.
    - Advised to maintain **diligent records**

"working to ensure that this funding is distributed in a way that is fast, fair, simple, and transparent"

- HHS Secretary, Alex Azar

- **Medicare Advance Payments**
  - Part A providers and Part B suppliers
  - $34 billion delivered as of April 7
  - Repayment requirements
  - Advance up to six months of Medicare receipts with no interest owed for twelve months. Recoupment begins 120 days following receipt and demands for repayment at one year following receipt

"Healthcare providers are making massive financial sacrifices to care for the influx of coronavirus patients…many are rightly complying with federal recommendations to delay non-essential elective surgeries to preserve capacity and personal protective equipment. They shouldn't be penalized for doing the right thing. Amid a public health storm of unprecedented fury, these payments are helping providers and suppliers – so critical to defeating this terrible virus – stay afloat."

- CMS Administrator, Seema Verma

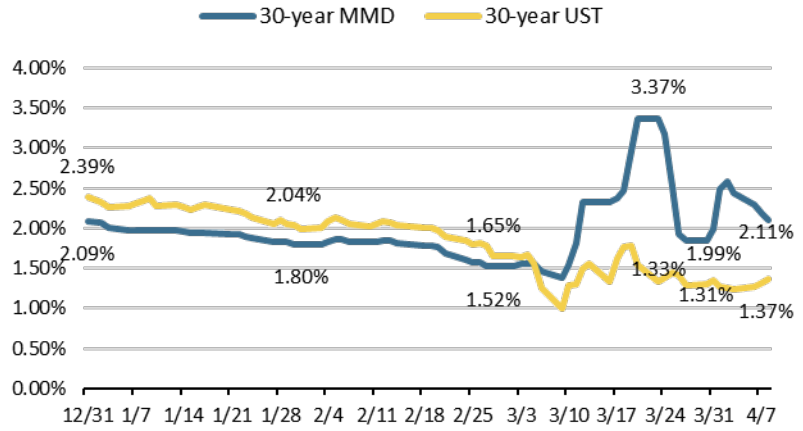
Sources of Relief

- **Federal Programs**
  - Medicare Sequestration Relief
    - Eliminates 2% reduction on Medicare payments
  - Medicaid DSH FY2020 reduction eliminated
  - Medicare will increase DRG payments by 20% for COVID-19 patients during national emergency
    - Provider must agree not to balance bill these individuals for the cost of their care
  - Telehealth reimbursement expansion and waivers
  - Paycheck Protection Program (Small Business Administration loans for organizations less than 500 employees)
- **Various State Grants**
- **Private Lender Loans**

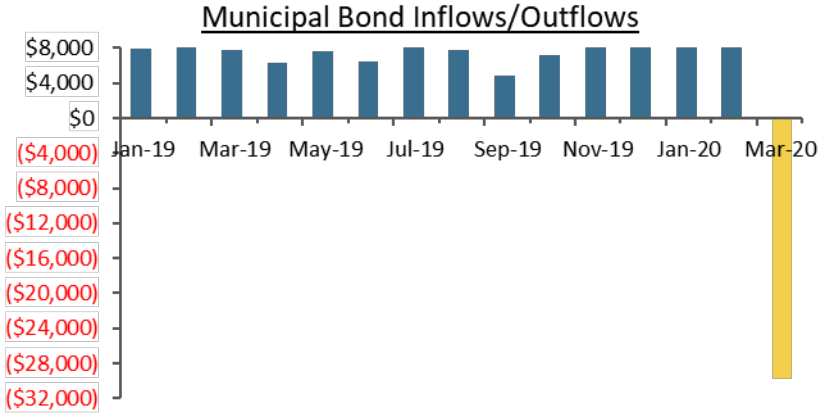
Public Fixed Rate Market

Unprecedented market volatility in March reminded us all that supply and demand remain the key driver in the municipal market, especially in times of crisis.

- A 'flight to quality' has caused money to flow out of munis, and increased volatility
  - $25B outflows in two weeks
  - AAA MMD at 300% of UST at peak
  - Rates up 199 bps in first two weeks of March, before falling 153 bps in 4 days, then rising and falling again
  - Despite fluctuations, taxable rates are significantly lower and tax exempt index rates are nearly flat on the year
- Many bond offerings remain on hold or in 'day-to-day' status, with only high grade well known credits testing the markets



Source: Thomson Reuters

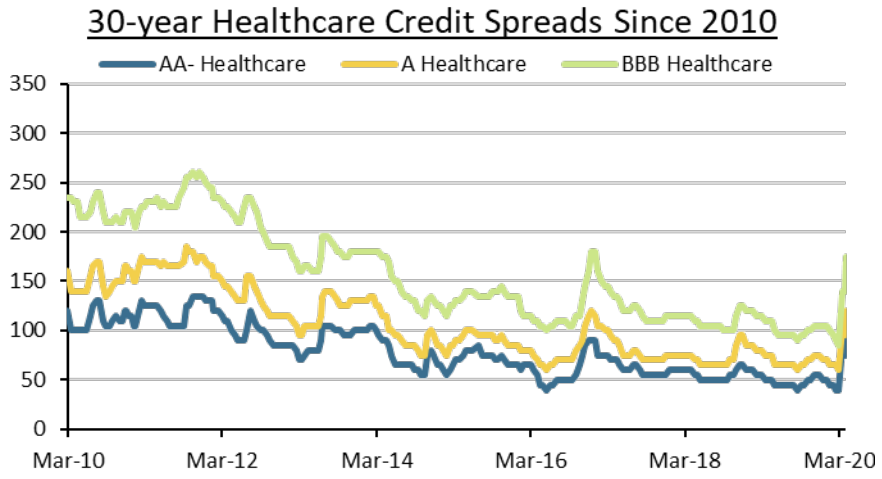


Source: Investment Company Institute (ICI), numbers in millions.

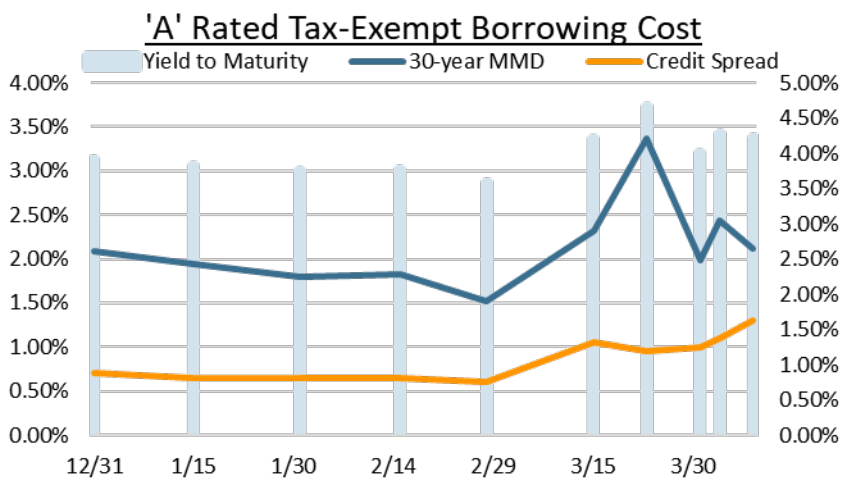
Data as of April 8, 2020.
MMD is the Municipal Market Data index based on "AAA" rated General Obligations ("GO") bonds. A GO is a common type of municipal bond that is secured by a state or local government's pledge to use available resources, including tax revenues, to repay bond holders.
The 30-year Treasury is a U.S. Treasury debt obligation rated "AAA" that has a maturity of 30 years

Healthcare Credit Spreads

Due to operating pressures and uncertainty, tax-exempt healthcare credit spreads have increased 50 to 90 bps (slightly above 10-year averages).



	AA-	A	BBB
Current	0.95%	1.30%	1.85%
1 Year Average	0.50%	0.71%	1.03%
10 Year Average	0.83%	1.12%	1.58%



	12/31/2019	4/8/2020	Net YTD Change
30-year MMD	2.09%	2.10%	0.01%
Credit Spread	0.70%	1.30%	0.60%
Yield to Call	2.79%	3.40%	0.61%
Yield to Maturity	3.91%	4.20%	0.29%

Note: Assumes a 5.00% coupon.

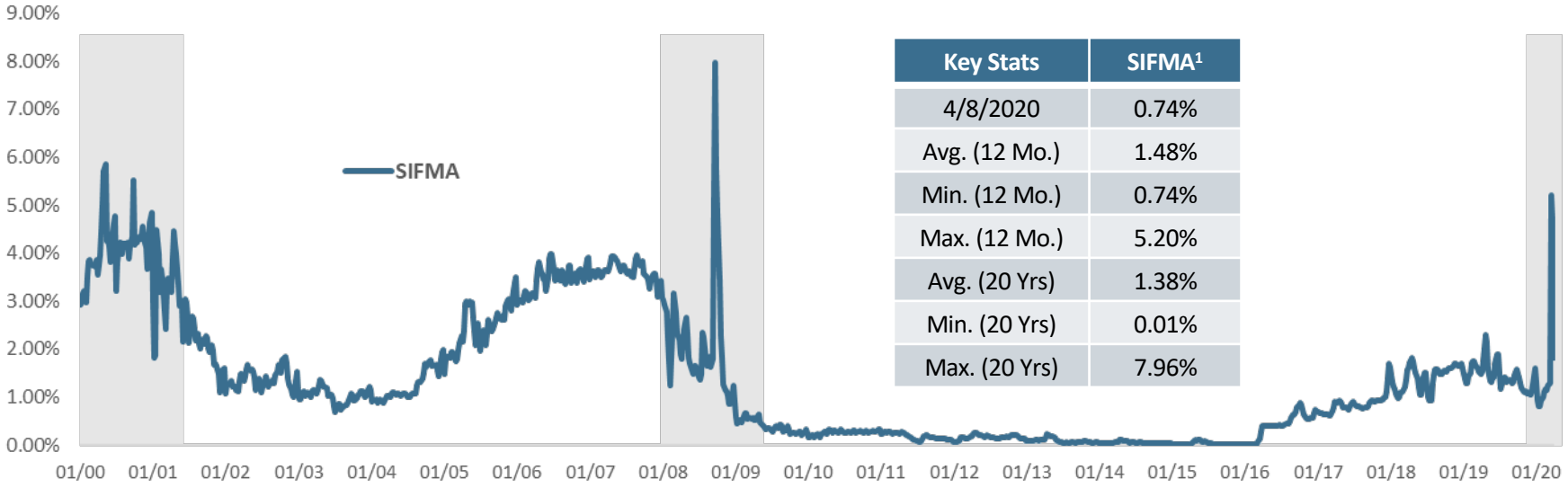
- Despite the increase in credit spreads YTD, all-in borrowing cost remains well below historical averages given nominally low index rates

Source: Thompson Reuter's & Ponder & Co.

Short Term Market

After nearly a month of volatile short-term rates, the variable rate market is starting to steady after the FED's stabilization efforts in late March.

- With the liquidity crunch, rates jumped as much as 10% in a week, but returned to normalcy as the FED backstopped most variable products
  - Daily rate VRDBs, which had risen to over 10%, have steadily declined to below 1%
  - Weekly VRDBs and CP remains elevated, trading higher than Daily VRDBs, but far lower than their peak

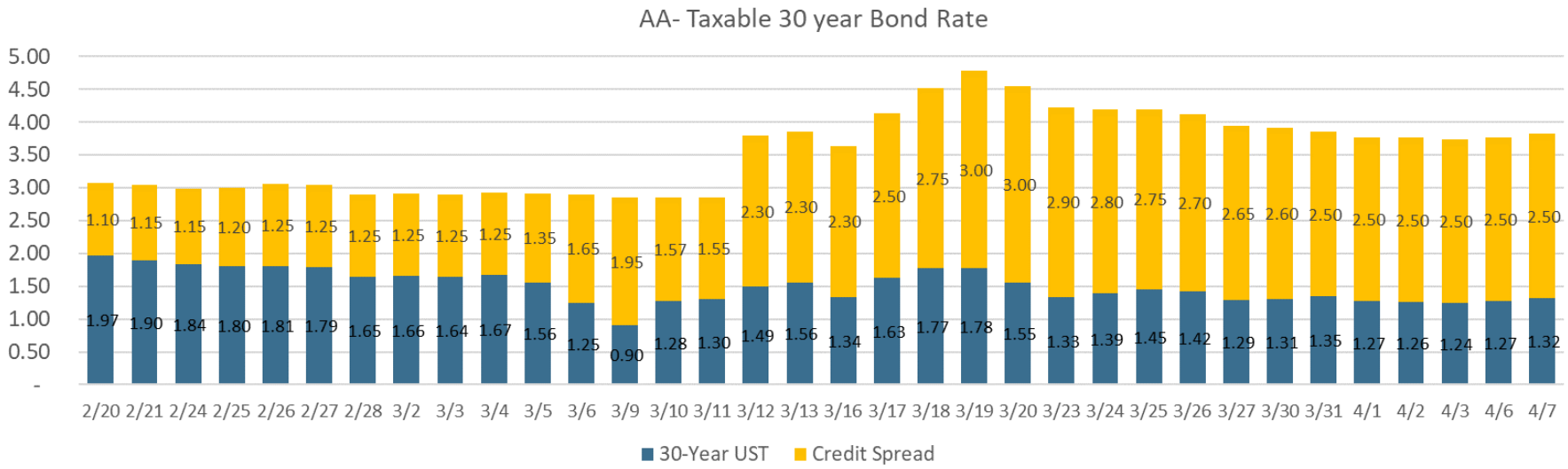


Key Stats	SIFMA[1]
4/8/2020	0.74%
Avg. (12 Mo.)	1.48%
Min. (12 Mo.)	0.74%
Max. (12 Mo.)	5.20%
Avg. (20 Yrs)	1.38%
Min. (20 Yrs)	0.01%
Max. (20 Yrs)	7.96%

1. The SIFMA Municipal Swap index is a 7-day high-grade market index comprised of tax-exempt VRDOs reset rates that are reported to the Municipal Securities Rule Making Board's (MSRB's) SHORT reporting system.

Taxable Municipal Market

As treasuries have continued to decline in 2020, credit spreads have increased as investors seek to maintain minimum yield levels.



- While 30-year treasury rates are down over 100 bps, credit spreads have increased by 125 bps erasing any benefits of the lower treasury rates

	12/31/2019	4/8/2020	Net YTD Change
30-year UST	2.38%	1.37%	-1.01%
Credit Spread	1.25%	2.50%	1.25%
Borrowing Rate	3.63%	3.87%	0.24%

Source: Ponder & Co.

Rating Agency Reactions

All 3 rating agencies have revised their 2020 outlooks on the not-for-profit healthcare sector from ‘stable’ to ‘negative’.

Moody’s

Revised on March 18, 2020

- Revenue challenges due to cancelations of elective surgeries and other out-patient procedures
- Expense cost increases for supplies such as PPE in addition to higher staffing costs
- Hospitals could face covenant challenges, namely debt service coverage and days cash on hand as entities see reduction in value of hospitals’ investment portfolios
- Reduced visits possible due to unemployment increases and loss of health benefits

S&P

Revised on March 25, 2020

- Sizable increases in operating costs combined with reduced volumes in the profitable elective and
- Measurable declines in unrestricted reserves and non-operating revenue due to investment portfolio losses
- Lower rated credits likely to feel more of the impact, expect multi-state and regional systems to perform better due to diversification of resources and geographical reach
- Will maintain currently surveillance cycle, but may begin targeted reviews of more at-risk entities

Fitch

Revised on March 27, 2020

- Higher rated credits should have cushion to withstand operating pressures over the short term, whereas smaller single-site facilities with lower liquidity levels have heightened credit risk
- Hospital staffing levels could become challenged if staff become sick, further increasing expenses
- If outbreak persists longer term, hospitals may face weakened payor mix and lower volumes and may delay new facility projects, reducing operating margins and pressuring ratings

Debt Covenants

Managing Debt Covenants

- Financial covenants for healthcare borrowers can vary but generally include some mix of debt service coverage, liquidity (days cash), and leverage (debt to cap)
- As health systems approach covenants calculation dates, they should:
  - Test projections against covenant limits
  - Discuss waivers with lenders
  - Take actions to avoid the violations where possible
    - Take realized gains in their investment portfolio (increase income available)
    - Defer expenses
    - Delay capital expenditures (increase days cash)
    - Issue long term debt (increase days cash)
    - Transfer cash to subsidiaries to assure debt service payments (keep debt service low by avoiding recognition of debt guarantees)
  - Engage others sooner than later

Real Estate as Capital

Most health systems have significant capital allocated to real estate

- **Balance Sheet**
  - Property, Plant & Equipment
  - Construction in Progress
  - Capital Improvements
  - Leasehold Interests

30 – 35% Total Assets
Real estate typically one of largest assets on balance sheet

- **Income Statement**
  - Rental Income / Expense
  - Real Estate Operating Expenses
  - Real Estate-Related Debt Service

Top 5 Expense
Real estate typically one of largest expense items on income statement

Real Estate Capital Strategies

Are traditional approaches practical in current environment?

- **Institutional Debt / Bond Market**
- **Banks / Regional Lenders**
- **Third Party Capital - REIT / Private Equity**
  - Monetization - sale / leaseback
  - Outright disposition
  - Development partner

Key considerations

- Timing / urgency – short-term liquidity or long-term capital need?
- Human capital requirements
- Lender of Buyer Capacity

Real Estate Lending

Significant uncertainty and extreme caution in commercial real estate lending environment

- **Capital Constraints**
  - Financial Capital and Human Capital
    - Servicing existing loans and related modification requests
    - Lines of credit – draw downs and limit increase requests
    - Flood of SBA loan applications

- **Extremely cautious position**
    - Limited “new money” lending activity, if any
    - Uncertain underwriting criteria
    - Short-term credit (<1 year)
    - Rate still historically low, but higher credit spreads and floating rate floors

Real Estate Market Retraction

Healthcare RE Investment Market – Many REITs withdraw acquisition guidance

Market Survey / Investor Perspective

25 Respondents
Public / Private REITS, Private Equity, Other Investors

Key Takeaways:

- **73%** plan to **continue acquiring** properties

BUT….

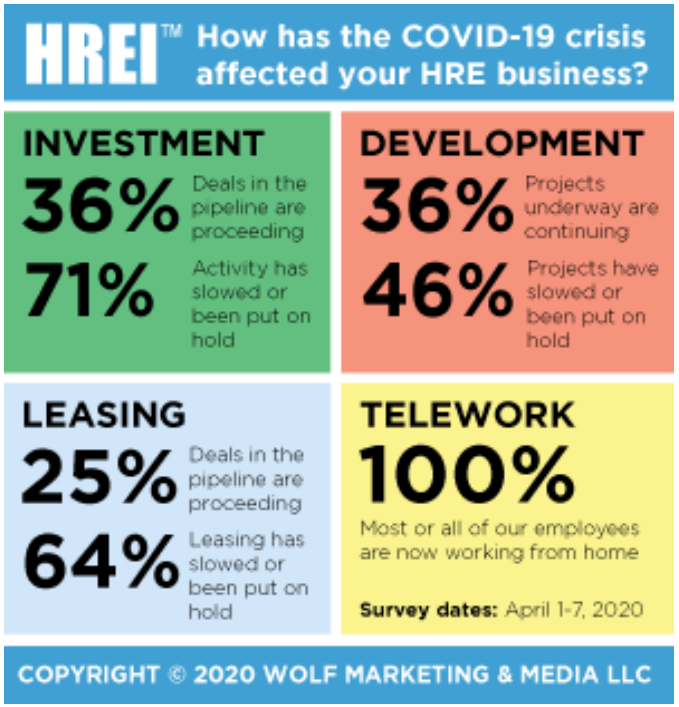
- **64% anticipate delays** in typical transaction timelines
- **45%** are **re-evaluating current deal pipeline** (under LOI)
- **45%** plan to change or are uncertain about future **acquisition criteria**
- **58%** anticipate a **degradation of market pricing** (i.e., lower prices)
- Most anticipate market stabilization in **late Q2 or Q3**

Source: ERE Healthcare Real Estate Advisors; Special Report – Healthcare Real Estate Investor Insight, April 2020; http://ereadv.com/insight/

Real Estate Market Retraction

Broader impact – Healthcare Development and Leasing also slowed

Market Survey / Broader Real Estate Industry Perspective



28 Respondents
Healthcare Real Estate Industry Professionals

Projects slowed or put on hold:

- **Investment: 71%** of projects
- **Development: 46%** of projects
- **Leasing: 64%** of projects

Source: *Healthcare Real Estate Insights; Wolf Marketing and Media LLC. www.wolfmediausa.com. April 8, 2020.*

Real Estate: Immediate Actions

How can ***Hospital Landlords*** manage real estate expenses?

- **Revenue Reduction**
  - Likely to experience significant negative cash flow impact due to temporary practice closures and related rent relief requests
  - Regulatory relief (CMS Blanket Waivers), but significant administrative burden remains

- **Proactive Expense Management**
  - Heavy reliance on property management / facilities team / service providers
    - Track all additional services / tenant requests (bill-back)
    - Reduce services / hours of operation where possible
    - Potentially close non-essential buildings
    - Temporarily stop all non-essential capital projects / construction
    - Evaluate potential property tax reduction opportunities

Real Estate: Immediate Actions

How can ***Hospital Landlords*** manage real estate expenses?

- **Proactive Expense Management** *(continued)*
  - Service reduction opportunities
    - Reduce HVAC and utilities to “Vacant Status”
    - Eliminate janitorial services to closed locations
    - Eliminate monthly inspections and preventive maintenance (unless mandated by Joint Commission)
    - Eliminate all non-critical repairs and capital improvements
    - Reduce grounds / landscaping services, eliminate spring planting, mulching, trimming
    - Eliminate window cleaning
    - Reduce vendor services – garbage, med waste, shredding
  - Property tax reduction opportunities
    - Recently acquired properties
    - Properties occupied by hospital departments or employed physician practices

Real Estate: Immediate Actions

How can ***Hospital Tenants*** manage real estate expenses?

- **Request Rent Relief from Landlords**
  - Partial / full relief – case-by-case analysis
  - Rent abatement / deferral / forgiveness

Rent Savings
1 month = 8.3%
2 months = 16.6%

- **Centralize services and temporarily close non-essential locations**
  - Urgent care
  - Physical therapy

- **Reduce / suspend all non-essential services for closed locations**
  - Reduce HVAC and utilities to “Vacant Status”
  - Eliminate janitorial services
  - Reduce vendor services – garbage, med waste, shredding, phone / internet, etc.

Long Term Real Estate Impact

Only time will tell the lasting effects …

- **Anticipated spike in demand for elective procedures**
  - Extended hours, potential 6-7 days / week until stabilized

- **Impact on Physician Community**
  - Physician consolidation / employment models
  - Rise in Telehealth and impact on traditional office space needs

- **Re-evaluation of overall Hospital real estate strategy**
  - Lease vs. own decision and various financing alternatives
  - Space consolidation opportunities
  - Elimination of select locations
  - Administrative space decisions

PYA, P.C.

800.270.9629 | pyapc.com