Top Three Financing Trends for 2019-2020

May 9, 2019
Lancaster Pollard is a leading capital partner in the healthcare and senior care sectors for over 30 years.

The Presenter (by the numbers):
Quintin Harris, Banker – Minneapolis, MN
- 14 years at Lancaster Pollard
- 7 years service with Peace Corps
- 3 sons
- 2 hyper dogs

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“We BRIDGE THE GAP between capital and our clients to help them achieve their goals. We do this by leveraging our collaborative culture to provide exceptional customer service, innovative financial solutions and meaningful long-term partnerships.”

Advisory
- M&A Advisory (Buy-Side and Sell-Side)
- Sale Lease-Back Advisory
- Equity Capital Deployment Advisory
- Restructuring
- Financial Derivatives
- Remarketing
- Financial Consulting
- Clinical Operations Advisory

Capital Markets
- Tax Exempt and Taxable Bonds
- Public or Private Security Offerings
- Private Debt Placements
- FHA-Insured Mortgage Loans
- USDA-Guaranteed Mortgage Loans
- GNMA Issuer/Servicing
- Fannie Mae Seniors & Affordable Housing
- Mortgage Loan Servicing

Merchant Banking
- Direct Balance Sheet Lending & Investing
- Bridge Loan Funding
- Term Debt for Acquisitions, Renovations & Turnaround Financing
- Partnership with Best-in-Class Operators
- New Developments and Acquisitions
- 100% Equity Investment
- Triple Net Lease with Pre-Negotiated Purchase Options

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Agenda

- Overview of the bond market & Debt Options
- Economic & interest Rate Forecasts
- Trends
  - #1: Flat Yield Curve
  - #2: Creative Refinancings
  - #3: USDA Community Facilities Program
History of Bonds

~2400 B.C
   First recorded bond on a stone discovered in Mesopotamia
     Currency: CORN

Middle Ages
   Venice issues government bonds to fund Venice’s growth as a Mediterranean power and defense
     Rate: ~5% (semi-annual interest payments)

1913
   The Sixteenth Amendment was codified in the Revenue Act of 1913 to provide for the exemption of interest on State and Local Bonds

1986
   Tax Reform Act greatly reduced private activities that may be financed with tax-exempt bond proceeds and expanded rules
$3.9 trillion capital market

Approximately 1 million outstanding municipal securities

Around 39,000 daily trades in municipal securities

Approximately $11 billion in par traded every day

Nearly 2/3 of municipal securities held by individual investors either directly or through mutual funds

Default rates for investment-grade municipal bonds were 0.18% compared to 1.74% for investment-grade corporate bonds

Source: MSRB

• $442 billion of municipal securities issued annually
  • Includes refundings
  • Muni market is small compared to corporate securities market size of $8.8 trillion
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Municipals vs. Private Activity Bonds

- Governmental Bonds (i.e. “Municipals”)
  - Courthouses, highways, sewer/water facilities, schools, some types of healthcare facilities

- Private Activity Bonds
  - Nonprofit senior living facilities & hospitals, affordable rental housing, utilities, colleges & universities, airports
  - Have a public benefit
  - Government body is issuer & lends proceeds to borrower

![U.S. Municipal Bonds Issuance - 2017](chart)

- Total: $408.4 billion
- Education, 26%
- General Purpose, 22%
- Transportation, 14%
- Healthcare, 9%
- Utilities, 9%
- Housing, 4%
- Development, 3%
- Other, 13%

Source: Thomson Reuters
General Obligation vs. Revenue Bonds

- **General Obligation (“GO”) Bonds**
  - “Full faith, credit and taxing power” of the issuer is pledged to and obligated to be used for the repayment of the bonds
  - Voter approval may be required
  - Taxes may be ad valorem (real estate), sales or special purpose tax

- **Revenue Bonds**
  - Specific revenues (e.g., hospital net revenue) is sole source of payment for debt service.
  - Credit analysis focuses solely on the borrower’s business...not the demographics of the taxing district.
Primary Debt Options – Rural Markets

- Bonds
- Private Placement
- Public Issuance
- Direct Loan
- Guaranteed Loan
- USDA
General market healthcare yields for A and BBB rated credits decreased by ~ 64 basis points over the past 12 months. Current yields are well below their longer-term averages.
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Economic Outlook

Real GDP Growth Forecast

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<th>Year</th>
<th>4-Quarter Average Y/Y Change</th>
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<tbody>
<tr>
<td>2019</td>
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<tr>
<td>2020</td>
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<td>1.80%</td>
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<td>0.40%</td>
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Economic Outlook

Core PCE Forecast

- 2019: 1.60%
- 2020: 2.10%
- 2021: 1.50%

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Economic Outlook

Unemployment Rate Forecast

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<th>12-Month Average</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
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<td>3.20%</td>
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<td>3.60%</td>
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<tr>
<td></td>
<td>4.50%</td>
<td>5.30%</td>
<td>5.30%</td>
</tr>
</tbody>
</table>
Economic Outlook

**10-Year Treasury Yield Forecast**

- **Jun-19**: 3.20%
- **Sep-19**: 3.40%
- **Dec-19**: 3.70%
- **Mar-20**: 3.85%
- **Jun-20**: 3.95%
- **Sep-20**: 4.00%
- **Dec-20**: 4.10%
- **Mar-21**: 4.20%
- **Jun-21**: 4.30%

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Trend #1 – Flat Yield Curve

The yield curve flattened as a result of interest rate hikes in 2018, reduced supply of municipal bonds in the market, and robust demand from investors.
Trend #2 Creative Refinancings

- Sandwich Bonds
- Cinderella Bonds
- HUD 242/223(f) insured taxable loans
- USDA Community Facilities loans
Trend #3 – USDA Community Facilities Program

- New construction, expansions, renovations & acquisitions
- 2018 Farm Bill changes allowed refinance.
- Direct and Guaranteed loans available or combine with tax-exempt bonds
- Requires a mortgage (when legally available)
- For populations of < 50,000
- Two-stage funding process
USDA and Tax-exempt Bonds

- Cross-over Documents/Steps
  - Plan of Finance
  - Financial Feasibility Study
  - Environmental
  - Mortgages – applicable for 501c3 entities and some governmental-owned projects
  - Appraisal - If there will be a mortgage
  - Public Hearings

- Requirements Distinct to USDA
  - Preliminary Architectural Review
  - Authorization to Take Bids Process
  - Pre-approval of alternative construction delivery methods
USDA and Tax-exempt Bonds - Recommendations

- Working with Bond Counsel that is familiar with USDA requirements regarding a) USDA procurement, b) title opinions, and c) closing instructions processes

- Multi-track construction financing options: rated Bond Anticipation Notes and Private Placements
  - The investment banking firm should compute the net present value (“NPV”) of each option

- Draft issuance documents for construction financing and parity debt while collating USDA application
  - Investment Bank can provide term sheet with accurate expectations but needs to complete the sales process after having commitment from USDA to lock in financing terms

- Outsource the Environmental Assessment (“EA”) to stay on schedule

- Select and seek approval of construction delivery method early in the USDA application process
Role of the Investment Banker/Advisor

- Bankers/Advisors bring financings to the market and have broad knowledge of the following:
  - Industry expertise (healthcare, infrastructure, education, etc)
  - Capital markets
  - Credit underwriting
  - Financing options
  - Debt structuring
  - Document preparation
  - Marketing/distribution procedures

- Bankers/Advisors and their teams serve as the key contact/liaison with the borrower and coordinate with all parties to the financing to execute the underwriting
The World View – Density of Medical Doctors

Source: World Health Organization 2019
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