



Thomas Weyl
+1 212 526 0751
thomas.weyl@barclays.com

Affordable Care Act: Challenges and Opportunities for Hospitals

Municipal Analysts Group of New York

May 2014

Background on the Affordable Care Act

Goals of the ACA

- Increase the quality and affordability of health insurance
- Lower the uninsured rate by expanding public and private insurance coverage
- Reduce the cost of healthcare for individuals and governments

ACA Requirements or Provisions

Expansion of Coverage

- Individual mandates
- Employer mandates
- Health insurance exchanges
- Federal subsidies
- Expanded Medicaid eligibility
- Extend coverage of children until the age of 26

Other Requirements and Provisions

- Guaranteed issue/no denial of coverage
- Community rating
- Minimum standards for health insurance policies
- Medicare rate cuts
- Bundled payments
- Accountable care organizations

Challenges for Healthcare Providers Posed by the ACA

Issues with Expanded Coverage

- Expanded insurance coverage and increased use rates of the previously uninsured are positives. However, there are some issues with the methodology:
 - Shift of insured patients from relatively high paying commercial plans to lower paying exchange based plans
 - Exacerbation of trend toward high deductible plans – increasing a portion of the self pay aspect of payor mix and increasing bad debt
 - Adverse selection risk – resulting in increasing insurance premiums and/or decreased reimbursement

Other Challenges

- Medicare rate cuts to finance low income subsidies
- Integration risk
- Narrow Networks
- Provisions that do not work – Community Living Assistance Services and Supports (CLASS)

Provider Reaction to Pending Implementation of the ACA

- A continuation of trends already in place:
 - M&A – both vertical and horizontal
 - Expense control in anticipation of (additional) revenue pressures
 - Accelerated investments in IT

Hospital Investment Strategy

Post ACA Investment Strategy

Common wisdom dictates:

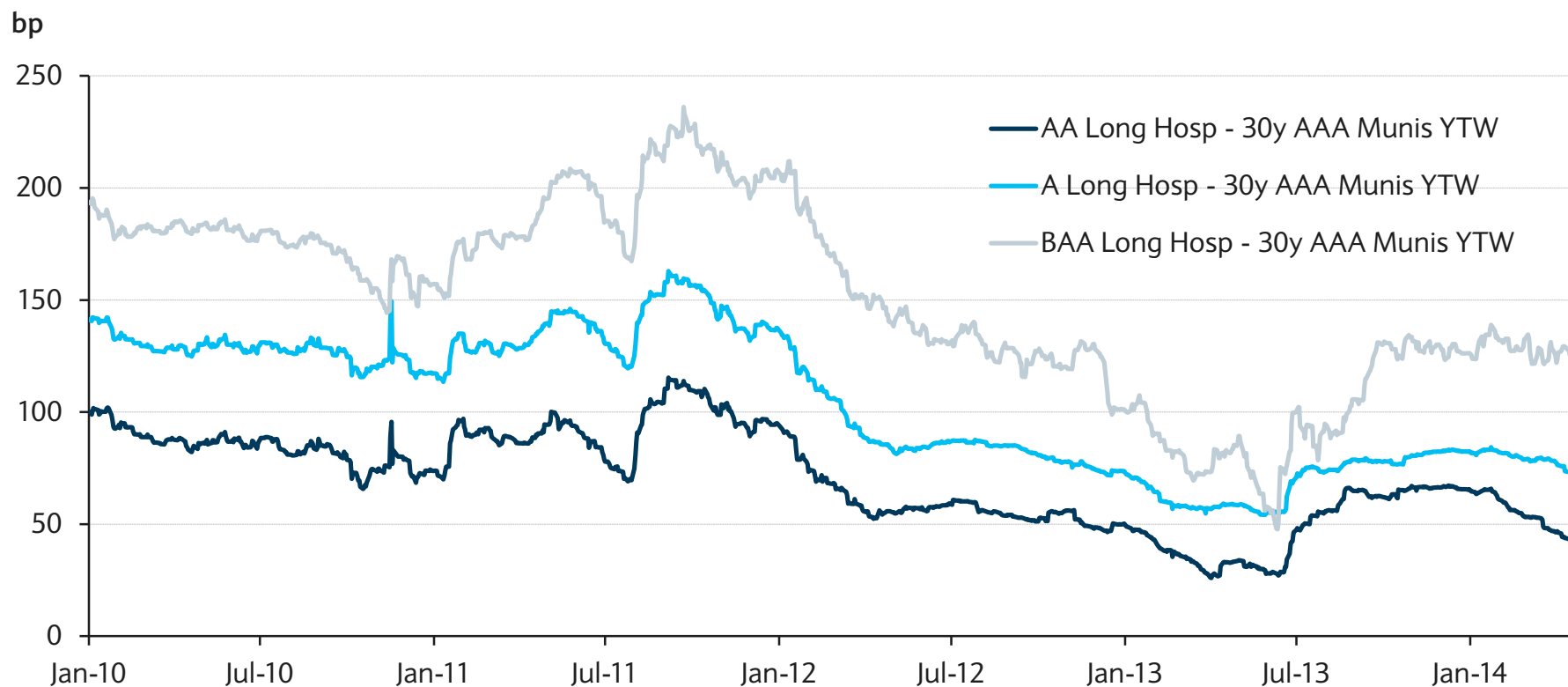
- The Rich get Richer – the Poor get Poorer

OR

- Buy the Strong and Avoid the Weak
 - Beware single site providers
 - Increasing scrutiny of marginal systems
 - Spread widening on perceived risk and actual credit weakness

New Paradigm?

Long Hospital YTW vs. 30y AAA-rated Tax-Exempt GO Yields



- The commonly accepted wisdom was wrong – or perhaps just early
- Spreads did not widen other than typical movements based on the overall muni market movements and in reaction to fund flow patterns

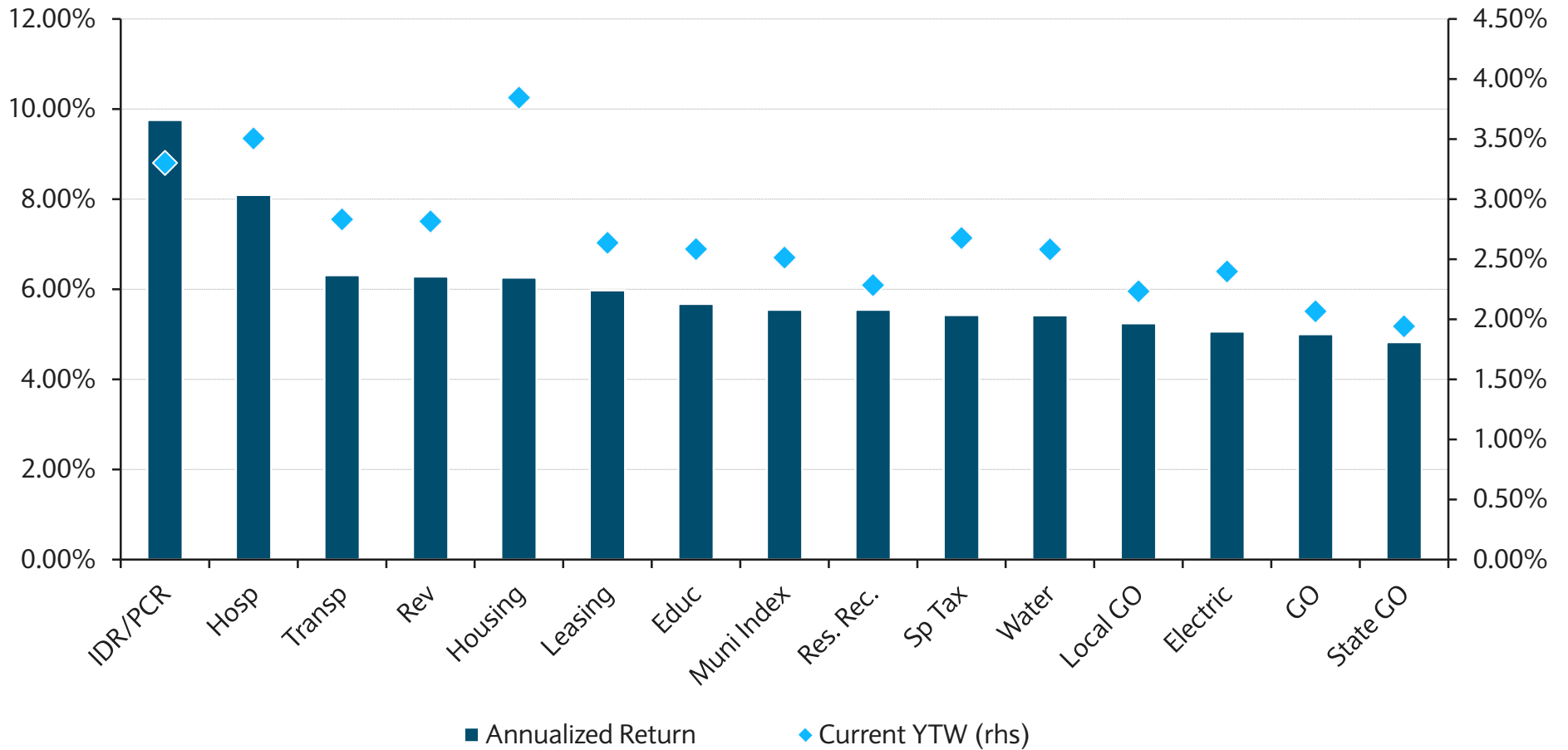
Source: Barclays Research

Muni Annualized Returns: May 2009 to April 2014

Municipal Index Annualized Returns by Sector

Annualized Return

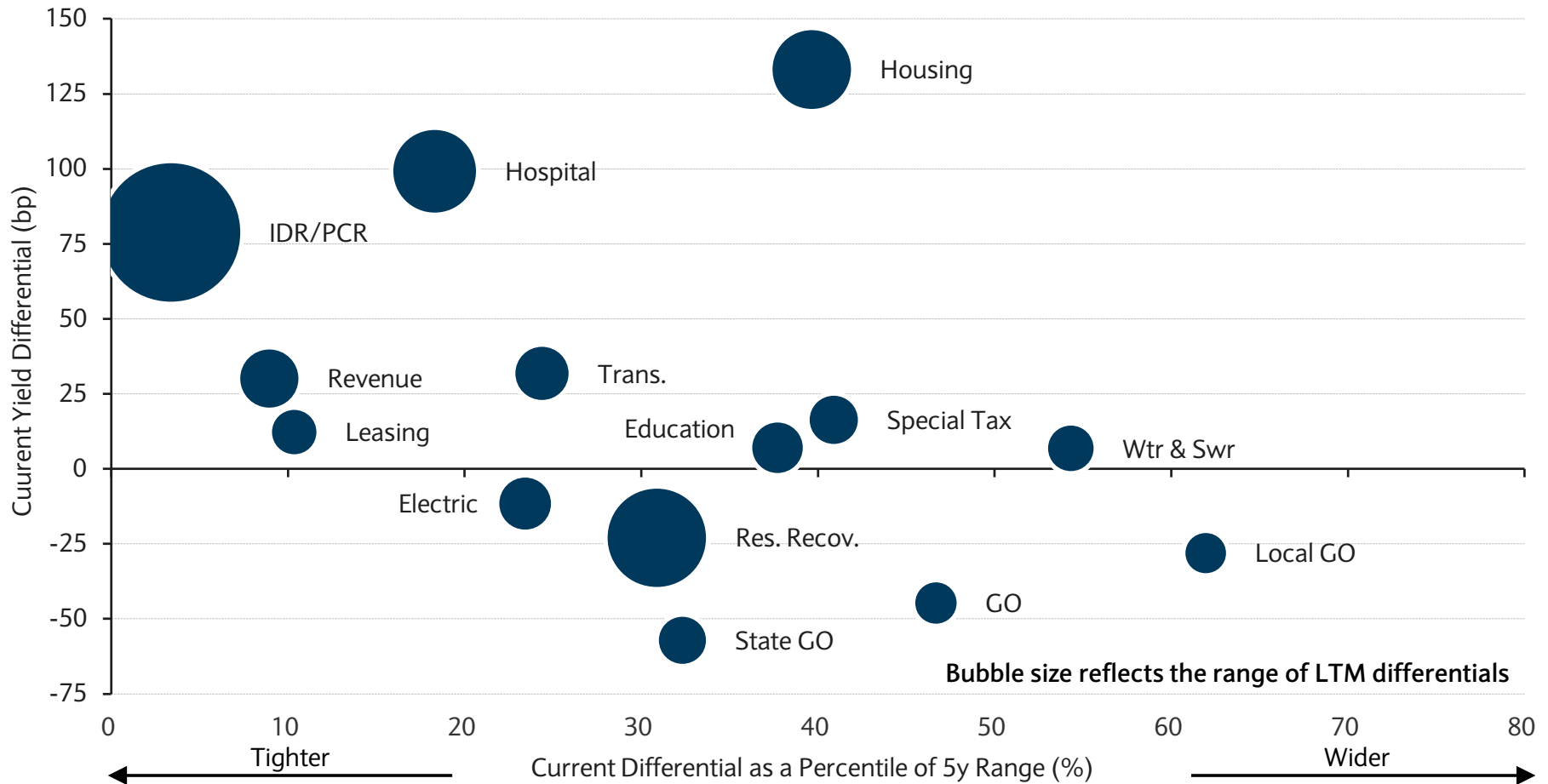
Current YTW



Source: Barclays Research

The Hospital Index Yields 100bp More than the Muni Index

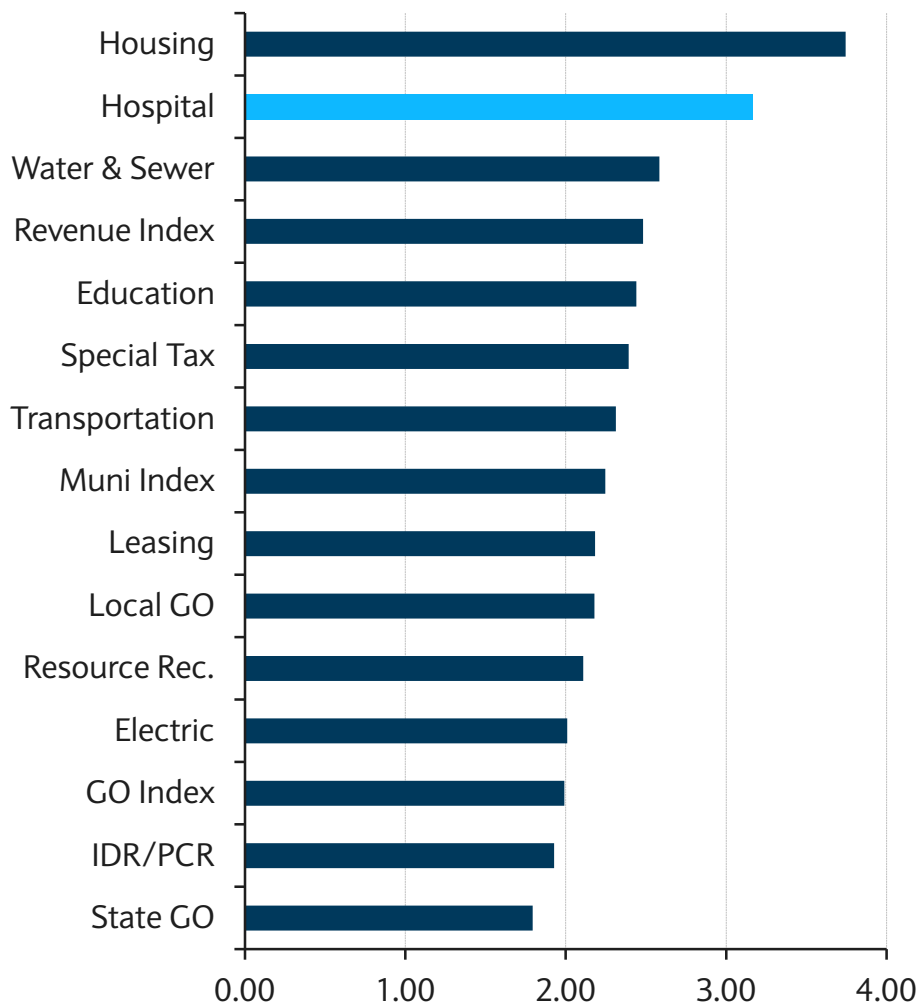
Muni Sector YTW Differential versus the Muni Index (5y Range)



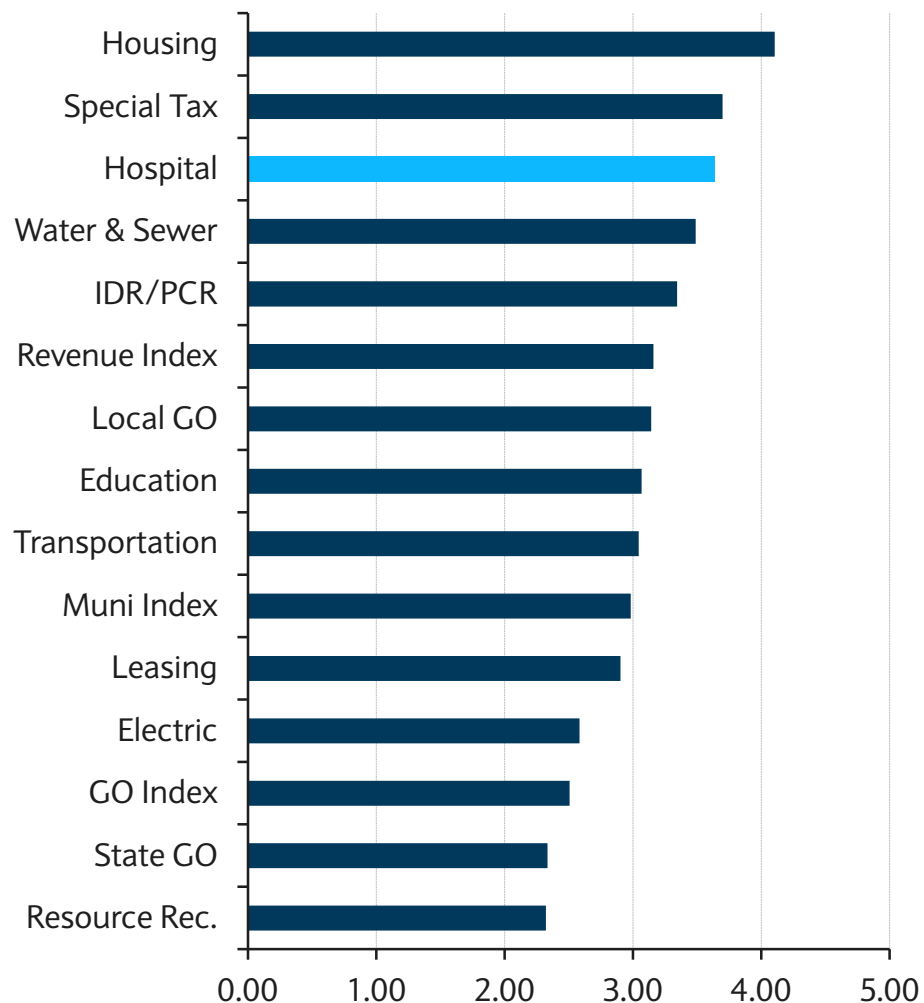
Note: As of April 30, 2014. The size of the bubble reflects the LTM range of differentials. For example, the differential between hospital and the muni index has been in a 94bp range (82-176bp) in the past five years, while that between special tax and the muni index has been in a 35bp range (2-37bp). Source: Barclays Research

Across Different Rating Buckets, Hospital Bonds also Offer Excess Yield

AA-rated Munis YTW (%)



A-rated Munis YTW (%)



As of April 30, 2014. Source: Barclays Research

Hospital Defaults Based on Moody's and S&P Studies

Obligor	State	Default Date	Last Rating	Original Rating	Recovery	Facility Closed?
Midlands Community Hospital	NE	1/1/1978	Caa	Baa	85%	N
Hilton Head Hospital	SC	1/1/1978	Caa	Baa	85%	N
St. Joseph's Hospital of Alton	IL	5/24/1989	CCC-	A		N
Central Medical Center	MO	6/7/1989	CCC-	BBB-		N
Metro Hospital	PA	12/19/1989	CCC	A-	64%	N
Choate-Symmes Health	MA	1/8/1990	CCC	A-	61%	N
Northwest General Hospital	MI	10/4/1990	C	BBB	33%	Y
Downtown Hospital Association	TN	8/1/1991	C	Baa	90 +%	N
Hyde Park Community Hospital	IL	12/17/1991	CCC	BBB		Y
Sacred Heart Medical Center	PA	1/8/1992	CCC	A-		N
Hialeah Hospital	FL	2/10/1992	CCC	BBB		N
Jackson Park Hospital Foundation	IL	3/4/1992	CCC	A		N
Jacksonville General Hospital	FL	4/2/1992	CCC	BBB		Y
James C. Guiffre Medical Center	PA	7/2/1992	CCC	BBB		Y
Parkview Hospital	OH	10/13/1994	C	A-		Y
Michigan Health Care Corp.	MI	9/20/1995	CCC	BB	10%	Y
Logan General Hospital	WV	2/3/1999	CCC	BBB		N
AHERF - DVOG	PA	7/21/1998			pending	N
Graduate Health System	PA	7/21/1998	CCC	A	pending	N
Boston Regional Medical Center	MA	2/1/1999	Ca	Baa	20%	Y
Greater Southeast Healthcare System	DC, MD	5/1/1999	Ca	Baa	less than 50%	N
South Fulton Medical Center	GA	4/27/2000	CCC	BBB+		N
Citizen's General Hospital	PA	1/1/2001	B1	B1	100%	N
Genesee Hospital	NY	5/1/2001	Caa2	A	undisclosed	N
Granada Hills Community Hospital	CA	5/14/2001	CCC	BBB-		Y
Crouse Health Hospital	NY	7/3/2001	CCC	BBB		N
Metro Health Center	PA	7/1/2002	Ca	A	21%	N
St. Francis Medical Center	PA	11/1/2002	Caa1	Baa1	< 100%	N
Mercy Hospital and Medical Center	IL	1/5/2004	CCC	A	100%	N
Fort Worth Osteopathic Hospital	TX	8/1/2004			100%/21%	Y
Forum Health	OH	9/1/2006	Ca	A2	100%	N
North Oakland Medical Center	MI	3/31/2008	B	BBB	10%	Y
Pascack Valley Hospital	NJ	9/30/2008	CC	A		Y
Lower Bucks Hospital	PA	12/15/2009	C	Baa	pending	N
Valley Health System	CA	6/4/2010	C	BBB-	100%	N
Northern Berkshire Healthcare	MA	6/20/2011	CCC	BBB-		Y

Based on Standard and Poor's Rating Universe (1986-2011) and Moody's Rating Universe (1970-2011). Recovery information based on Moody's data. Source: S&P, Moody's, Barclays Research

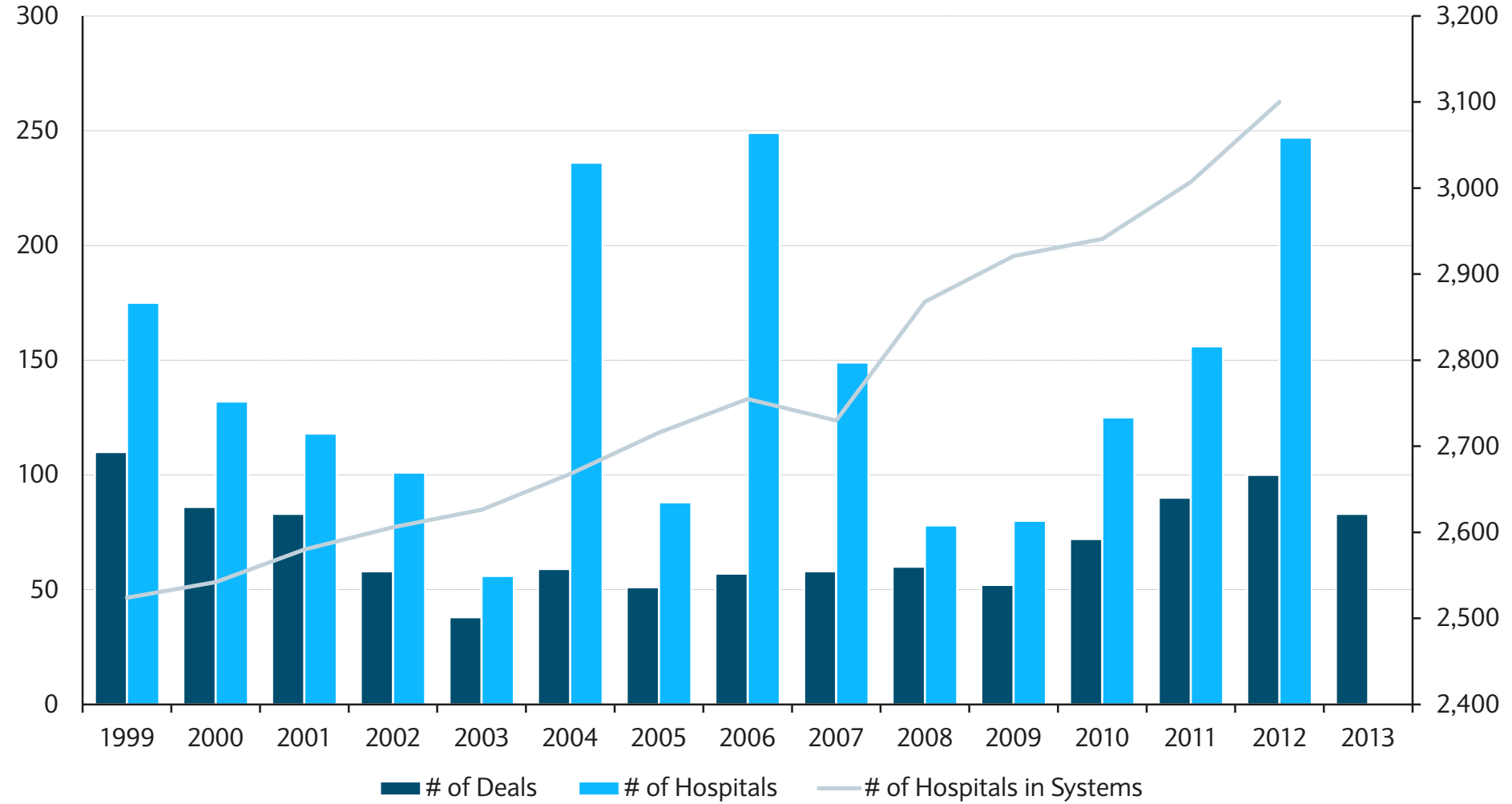
Hospital Defaults Summary

- Current Rating Universe
 - Moody's: 448
 - S&P: 600
- 36 defaults from 1978-2011 – less than 1 default per year
- 12 resulted in facility closure
- Recovery Data:
 - Average recovery for the 6* closures with recovery data: 65%
 - More realistic: 20%*
 - Overall recovery rate for the 18 defaults where data exists: 61%

Note: *One transaction is counted twice due to the 100% recovery on the insured debt and 21% recovery on the uninsured debt. Source: S&P, Moody's, Barclays Research

Hospital M&A Activity

Number of deals declined in 2013, but the number of hospitals likely increased



Source: AHA, Irving Levin Associates, Barclays Research

New(er) Paradigm

- The rich get richer, and the poor get poorer – but some get acquired
- Hospitals rarely close – this dynamic will likely change under healthcare reform, as more will close but many marginal facilities could be acquired
- Caritas and Detroit Medical Center
- Conemaugh:

“The strategic planning process, in part, came in response to the challenges health care systems across the country face, including increasing capital needs, reimbursement cuts and changing patient volumes, as well as a desire to position Conemaugh for population health management in this new era of health care. Given these factors, Conemaugh’s board recognized that the time is now to evolve and ensure the long-term success of the health system.”

http://www.conemaugh.org/template_pressrelease.aspx?id=12515

Muni Investors are Under-Allocated to Healthcare

- Hospital sector as a percent of the Barclays Municipal Index: 8.55%
- Bloomberg's holders search identified 108 holders of hospital bonds aggregated by investment firm
 - 14 holders invested at 9% of total holdings or above
 - 3 holders invested at 7%
 - 4 holders invested at 6%
 - 5 holders invested at 5%
- On the macro level, muni investors are under-allocated to healthcare

Summary

- Healthcare provides high yield with high total return performance.
- According to rating agency reports, no hospital or hospital system rated higher than A has ever defaulted.
- Risk premium for hospitals appears excessive, given the limited default history (less than 1 per year) and relatively high recovery rates (60% based on limited data set).
- While investors fear closures and defaults due to healthcare reform, the business changes will likely occur over a relatively longer horizon while historically weaker credits tend to merge or be acquired.
- The importance of credit selection is increasing.
- **The largest opportunity is simply to allocate portfolios to hospitals adequately.**

Analyst Certifications and Important Disclosures

Analyst Certification(s)

I, Tom Weyl, hereby certify (1) that the views expressed in this research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this research report and (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this research report.

Important Disclosures:

Barclays Research is a part of the Corporate and Investment Banking division of Barclays Bank PLC and its affiliates (collectively and each individually, "Barclays"). For current important disclosures regarding companies that are the subject of this research report, please send a written request to: Barclays Research Compliance, 745 Seventh Avenue, 14th Floor, New York, NY 10019 or refer to <http://publicresearch.barclays.com> or call 212-526-1072.

Barclays Capital Inc. and/or one of its affiliates does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that Barclays may have a conflict of interest that could affect the objectivity of this report. Barclays Capital Inc. and/or one of its affiliates regularly trades, generally deals as principal and generally provides liquidity (as market maker or otherwise) in the debt securities that are the subject of this research report (and related derivatives thereof). Barclays trading desks may have either a long and / or short position in such securities, other financial instruments and / or derivatives, which may pose a conflict with the interests of investing customers. Where permitted and subject to appropriate information barrier restrictions, Barclays fixed income research analysts regularly interact with its trading desk personnel regarding current market conditions and prices. Barclays fixed income research analysts receive compensation based on various factors including, but not limited to, the quality of their work, the overall performance of the firm (including the profitability of the investment banking department), the profitability and revenues of the Fixed Income, Currencies and Commodities Division and the potential interest of the firm's investing clients in research with respect to the asset class covered by the analyst. To the extent that any historical pricing information was obtained from Barclays trading desks, the firm makes no representation that it is accurate or complete. All levels, prices and spreads are historical and do not represent current market levels, prices or spreads, some or all of which may have changed since the publication of this document. Barclays produces various types of research including, but not limited to, fundamental analysis, equity-linked analysis, quantitative analysis, and trade ideas. Recommendations contained in one type of research may differ from recommendations contained in other types of research, whether as a result of differing time horizons, methodologies, or otherwise. Unless otherwise indicated, Barclays trade ideas are provided as of the date of this report and are subject to change without notice due to changes in prices. In order to access Barclays Statement regarding Research Dissemination Policies and Procedures, please refer to <https://live.barcap.com/publiccp/RSR/nyfipubs/disclaimer/disclaimer-research-dissemination.html>. In order to access Barclays Research Conflict Management Policy Statement, please refer to: <http://group.barclays.com/corporates-and-institutions/research/research-policy>.

Disclaimer

This publication has been prepared by the Corporate and Investment Banking division of Barclays Bank PLC and/or one or more of its affiliates (collectively and each individually, "Barclays"). It has been issued by one or more Barclays legal entities within its Corporate and Investment Banking division as provided below. It is provided to our clients for information purposes only, and Barclays makes no express or implied warranties, and expressly disclaims all warranties of merchantability or fitness for a particular purpose or use with respect to any data included in this publication. Barclays will not treat unauthorized recipients of this report as its clients. Prices shown are indicative and Barclays is not offering to buy or sell or soliciting offers to buy or sell any financial instrument. Without limiting any of the foregoing and to the extent permitted by law, in no event shall Barclays, nor any affiliate, nor any of their respective officers, directors, partners, or employees have any liability for (a) any special, punitive, indirect, or consequential damages; or (b) any lost profits, lost revenue, loss of anticipated savings or loss of opportunity or other financial loss, even if notified of the possibility of such damages, arising from any use of this publication or its contents.

Other than disclosures relating to Barclays, the information contained in this publication has been obtained from sources that Barclays Research believes to be reliable, but Barclays does not represent or warrant that it is accurate or complete. Barclays is not responsible for, and makes no warranties whatsoever as to, the content of any third-party web site accessed via a hyperlink in this publication and such information is not incorporated by reference.

The views in this publication are those of the author(s) and are subject to change, and Barclays has no obligation to update its opinions or the information in this publication. The analyst recommendations in this publication reflect solely and exclusively those of the author(s), and such opinions were prepared independently of any other interests, including those of Barclays and/or its affiliates. This publication does not constitute personal investment advice or take into account the individual financial circumstances or objectives of the clients who receive it. The securities discussed herein may not be suitable for all investors. Barclays recommends that investors independently evaluate each issuer, security or instrument discussed herein and consult any independent advisors they believe necessary. The value of and income from any investment may fluctuate from day to day as a result of changes in relevant economic markets (including changes in market liquidity). The information herein is not intended to predict actual results, which may differ substantially from those reflected. Past performance is not necessarily indicative of future results.

This communication is being made available in the UK and Europe primarily to persons who are investment professionals as that term is defined in Article 19 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005. It is directed at, and therefore should only be relied upon by, persons who have professional experience in matters relating to investments. The investments to which it relates are available only to such persons and will be entered into only with such persons. Barclays Bank PLC is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority and is a member of the London Stock Exchange.

The Corporate and Investment Banking division of Barclays undertakes U.S. securities business in the name of its wholly owned subsidiary Barclays Capital Inc., a FINRA and SIPC member. Barclays Capital Inc., a U.S. registered broker/dealer, is distributing this material in the United States and, in connection therewith accepts responsibility for its contents. Any U.S. person wishing to effect a transaction in any security discussed herein should do so only by contacting a representative of Barclays Capital Inc. in the U.S. at 745 Seventh Avenue, New York, New York 10019.

Non-U.S. persons should contact and execute transactions through a Barclays Bank PLC branch or affiliate in their home jurisdiction unless local regulations permit otherwise.

Barclays Bank PLC, Paris Branch (registered in France under Paris RCS number 381 066 281) is regulated by the Autorité des marchés financiers and the Autorité de contrôle prudentiel. Registered office 34/36 Avenue de Friedland 75008 Paris.

This material is distributed in Canada by Barclays Capital Canada Inc., a registered investment dealer and member of IIROC (www.iiroc.ca).

Subject to the conditions of this publication as set out above, the Corporate & Investment Banking Division of Absa Bank Limited, an authorised financial services provider (Registration No.: 1986/004794/06. Registered Credit Provider Reg No NCRCP7), is distributing this material in South Africa. Absa Bank Limited is regulated by the South African Reserve Bank. This publication is not, nor is it intended to be, advice as defined and/or contemplated in the (South African) Financial Advisory and Intermediary Services Act, 37 of 2002, or any other financial, investment, trading, tax, legal, accounting, retirement, actuarial or other professional advice or service whatsoever. Any South African person or entity wishing to effect a transaction in any security discussed herein should do so only by contacting a representative of the Corporate & Investment Banking Division of Absa Bank Limited in South Africa, 15 Alice Lane, Sandton, Johannesburg, Gauteng 2196. Absa Bank Limited is a member of the Barclays group.

In Japan, foreign exchange research reports are prepared and distributed by Barclays Bank PLC Tokyo Branch. Other research reports are distributed to institutional investors in Japan by Barclays Securities Japan Limited. Barclays Securities Japan Limited is a joint-stock company incorporated in Japan with registered office of 6-10-1 Roppongi, Minato-ku, Tokyo 106-6131, Japan. It is a subsidiary of Barclays Bank PLC and a registered financial instruments firm regulated by the Financial Services Agency of Japan. Registered Number: Kanto Zaimukyokuchō (Kinshō) No. 143.

Disclaimer (continued)

Barclays Bank PLC, Hong Kong Branch is distributing this material in Hong Kong as an authorised institution regulated by the Hong Kong Monetary Authority. Registered Office: 41/F, Cheung Kong Center, 2 Queen's Road Central, Hong Kong.

Information on securities/instruments that trade in Taiwan or written by a Taiwan-based research analyst is distributed by Barclays Capital Securities Taiwan Limited to its clients. The material on securities/instruments not traded in Taiwan is not to be construed as 'recommendation' in Taiwan. Barclays Capital Securities Taiwan Limited does not accept orders from clients to trade in such securities. This material may not be distributed to the public media or used by the public media without prior written consent of Barclays.

This material is distributed in South Korea by Barclays Capital Securities Limited, Seoul Branch.

All equity research material is distributed in India by Barclays Securities (India) Private Limited (SEBI Registration No: INB/INF 231292732 (NSE), INB/INF 011292738 (BSE), Registered Office: 208 | Ceejay House | Dr. Annie Besant Road | Shivsagar Estate | Worli | Mumbai - 400 018 | India, Phone: + 91 22 67196363). Other research reports are distributed in India by Barclays Bank PLC, India Branch.

Barclays Bank PLC Frankfurt Branch distributes this material in Germany under the supervision of Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin).

This material is distributed in Malaysia by Barclays Capital Markets Malaysia Sdn Bhd.

This material is distributed in Brazil by Banco Barclays S.A.

This material is distributed in Mexico by Barclays Bank Mexico, S.A.

Barclays Bank PLC in the Dubai International Financial Centre (Registered No. 0060) is regulated by the Dubai Financial Services Authority (DFSA). Principal place of business in the Dubai International Financial Centre: The Gate Village, Building 4, Level 4, PO Box 506504, Dubai, United Arab Emirates. Barclays Bank PLC-DIFC Branch, may only undertake the financial services activities that fall within the scope of its existing DFSA licence. Related financial products or services are only available to Professional Clients, as defined by the Dubai Financial Services Authority.

Barclays Bank PLC in the UAE is regulated by the Central Bank of the UAE and is licensed to conduct business activities as a branch of a commercial bank incorporated outside the UAE in Dubai (Licence No.: 13/1844/2008, Registered Office: Building No. 6, Burj Dubai Business Hub, Sheikh Zayed Road, Dubai City) and Abu Dhabi (Licence No.: 13/952/2008, Registered Office: Al Jazira Towers, Hamdan Street, PO Box 2734, Abu Dhabi).

Barclays Bank PLC in the Qatar Financial Centre (Registered No. 00018) is authorised by the Qatar Financial Centre Regulatory Authority (QFCRA). Barclays Bank PLC-QFC Branch may only undertake the regulated activities that fall within the scope of its existing QFCRA licence. Principal place of business in Qatar: Qatar Financial Centre, Office 1002, 10th Floor, QFC Tower, Diplomatic Area, West Bay, PO Box 15891, Doha, Qatar. Related financial products or services are only available to Business Customers as defined by the Qatar Financial Centre Regulatory Authority.

This material is distributed in the UAE (including the Dubai International Financial Centre) and Qatar by Barclays Bank PLC.

This material is distributed in Saudi Arabia by Barclays Saudi Arabia ('BSA'). It is not the intention of the publication to be used or deemed as recommendation, option or advice for any action (s) that may take place in future. Barclays Saudi Arabia is a Closed Joint Stock Company, (CMA License No. 09141-37). Registered office Al Faisaliah Tower, Level 18, Riyadh 11311, Kingdom of Saudi Arabia. Authorised and regulated by the Capital Market Authority, Commercial Registration Number: 1010283024.

This material is distributed in Russia by OOO Barclays Capital, affiliated company of Barclays Bank PLC, registered and regulated in Russia by the FSFM. Broker License #177-11850-100000; Dealer License #177-11855-010000. Registered address in Russia: 125047 Moscow, 1st Tverskaya-Yamskaya str. 21.

This material is distributed in Singapore by the Singapore branch of Barclays Bank PLC, a bank licensed in Singapore by the Monetary Authority of Singapore. For matters in connection with this report, recipients in Singapore may contact the Singapore branch of Barclays Bank PLC, whose registered address is One Raffles Quay Level 28, South Tower, Singapore 048583.

Barclays Bank PLC, Australia Branch (ARBN 062 449 585, AFSL 246617) is distributing this material in Australia. It is directed at 'wholesale clients' as defined by Australian Corporations Act 2001.

IRS Circular 230 Prepared Materials Disclaimer: Barclays does not provide tax advice and nothing contained herein should be construed to be tax advice. Please be advised that any discussion of U.S. tax matters contained herein (including any attachments) (i) is not intended or written to be used, and cannot be used, by you for the purpose of avoiding U.S. tax-related penalties; and (ii) was written to support the promotion or marketing of the transactions or other matters addressed herein. Accordingly, you should seek advice based on your particular circumstances from an independent tax advisor.

© Copyright Barclays Bank PLC (2014). All rights reserved. No part of this publication may be reproduced in any manner without the prior written permission of Barclays. Barclays Bank PLC is registered in England No. 1026167. Registered office 1 Churchill Place, London, E14 5HP. Additional information regarding this publication will be furnished upon request. US27035