Municipal Market Comments

Ascent Investment Partners

August 20, 2012

from Montage Investments

Rating Agencies Highlight Risks in Health Care Bonds

All three of the municipal rating agencies released new reports this week discussing the trends in credit quality and outlook for the not-for-profit hospital sector of the municipal market. Moody's, S&P and Fitch are unanimous in their general view that the overall credit quality of hospitals increased slightly in 2011, and that many hospitals and health systems stabilized their operations and financial positions following very challenging years from 2008 to 2010. However, all three agencies also agree that the credit cycle in the health care sector appears to have reached a peak, and they share the outlook that credit quality in the sector will likely decline over the next few years as hospitals and health systems face the growing pressures resulting from the implementation of the Patient Protection and Affordable Care Act (ACA).

Moody's maintains a negative outlook on the health care sector as a whole for the coming year. Moody's sees a number of pressures that it expects to grow from now through 2014, including the consequences of the Supreme Court's ruling on the ACA. The ruling allows states to opt out of the Medicaid expansion in the Act, which could result in:

- Fewer uninsured individuals than originally projected receiving health insurance, which will limit potential new revenue flows in those states; and,
- Ongoing uncertainty for administrators trying to plan for the future operating and regulatory environment.

Hospitals and health systems also face pressures related to federal budget management and the uncertainty over the size and shape of future federal health care spending.

S&P also noted that the stabilization of hospital credit quality over the past two years is due in large part to the effective management of expenses. Going forward, the agency expects that hospitals will have a harder time maintaining some of these cuts as reimbursement rates from both government programs and private insurers remain under pressure, and the ability to find additional cuts in the future may be limited.

At Ascent, our current approach to health care is to avoid adding any exposure to client portfolios in the current market environment. We also generally avoid holding single-asset obligors, like stand-alone hospitals. We prefer larger, highly-rated systems with multiple facilities that are more geographically diverse. We believe this type of issuer is best positioned to adapt to changing health care law, with greater financial resources to deal with challenges, and the institutional capacity to more effectively manage operations and finances in challenging environments.

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