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HALL RENDER'S PRACTICALHEALTH

Health Care Is Economic Development

According to the Bureau of Labor Statistics, the health care industry is expected to produce more jobs than any other in the coming decade.

Quick, think of an industry projected to create millions of new jobs during the next 10 years – jobs that pay good wages, serve the community and cannot be outsourced overseas. If you thought of the health care industry, you are correct. According to the Bureau of Labor Statistics, the health care industry is expected to produce more jobs than any other in the coming decade. Nearly every economic development plan drafted by local government includes health care, both for the quality jobs it creates and because quality health care attracts employers from other industries. As a result, state and local governments are increasingly offering economic development and other incentives for health care projects.

Recently, the City of Indianapolis provided $38 million in funding to a $192 million neuroscience project expected to create 1,225 jobs. Hall Render clients have received economic development assistance from smaller local governments as well. Earlier this year, a Hall Render client opened a joint health care/recreational facility made possible in part by a multi-million dollar pledge of future tax increment from the host city. Another client recently developed multiple long-term care facilities with short-term credit enhancement provided by the host cities. This city support allowed the client to obtain construction financing at rates below 4%, in what would otherwise be a very difficult financing environment.

Opponents of economic development incentives will argue that health care development follows demographic trends. They say health care providers will develop projects where patients are, regardless of the incentives offered. In some respects, this is true. Certainly, clinical facilities need to be located in close proximity to the patient base. In most instances, however, the health care provider will consider multiple sites in different jurisdictions (perhaps in neighboring cities or counties).

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Health Care Is Economic Development (Continued)

While many factors go into making the ultimate site selection, the availability of local economic development incentives may make the difference. In other non-clinical situations (resource and administrative centers, for example), the provider may have many options.

Perhaps more importantly, local economic development support can make a substantial difference in the timing of projects. As anyone who has picked up a newspaper knows, it remains difficult to secure financing, particularly for new construction projects. While most health care providers have worthy projects on the drawing board, making them a reality often hinges on the availability of capital. Local economic development support can often bridge this gap, making a project viable today, rather than 3-5 years in the future. Given continued high unemployment, accelerating the implementation of these projects is often critical to local economies.

In summary, local governments are taking note of the job creation and other economic development benefits associated with health care projects. They have many tools in their toolbox that may be deployed to make health care project plans a reality. Health care providers considering new projects are well advised to consider the availability of economic development resources and enhancements. ■

Alternate Tax-Exempt Financing Options

Most non-profit health care providers have experience going to the tax-exempt bond markets for capital. While the capital markets remain a viable financing source for many, there are a handful of financing vehicles that appear to be picking up steam in the market. Non-profit health care providers may want to consider these alternatives in addition to more traditional options:

TAX-EXEMPT LEASING

This structure is often used for financing equipment and software. These leases are typically offered through equipment vendors or financial institution leasing programs and differ from typical capital leases in one important respect – they provide lower lease payments. In order for a lease to be tax-exempt, it has to be issued through a state or local government. A portion of the lease payment is designated as "interest" on which the lessor does not have to pay federal income tax. The result is that tax-exempt leases generally carry a lower interest rate than other types of leases or taxable loans.

BANK–HELD BONDS

With few opportunities to lend in the current economy, commercial banks have been buying tax-exempt bonds for their own accounts. Placement of tax-exempt bonds with commercial banks often results in lower transaction costs compared to a public offering of bonds, and they tend to offer more flexible terms and covenants. While commercial banks will generally not commit to hold bonds beyond 5-10 years, the flexible covenants and attractive rates may make the shorter term acceptable.

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Alternate Tax-Exempt Financing Options (Continued)

TAX INCREMENT FINANCING (TIF)

Most states have laws on the books that allow local governments to capture incremental taxes generated by development. The local government may capture incremental property, income, sales or other taxes, which can often be used to support development projects. TIF is often used to lure developers to a new area, and the pledge of TIF revenues to a project often makes the difference in a successful financing.

MIDWESTERN DISASTER AREA BONDS (DISASTER BONDS)

The Heartland Disaster Tax Relief Act of 2008 expanded the availability of tax-exempt bond financing for certain private use projects, which would not otherwise qualify for tax-exempt financing, such as industrial facilities or medical office buildings. States including Wisconsin, Indiana and Illinois received billions of tax-exempt bond "volume-cap" for further allocation to qualifying projects in certain counties.[1] Disaster Bonds must be issued by January 1, 2013.

USDA HEALTH IT FINANCING

USDA Rural Development offers several programs to support the financing of community facilities in rural areas and small towns. USDA direct loans and guarantees are available to local governments and non-profit entities. Recently, certain USDA programs were expanded to enable rural hospitals and clinics to fund health IT hardware and software. ■

[1] For a list of qualifying counties, see http://alturl.com/r37hi

IRS to Audit Based on Schedule K Disclosures

By now, most health care organizations are familiar with Schedule K reporting and post-issuance compliance for tax-exempt bonds. However, according to the IRS, "best efforts" are not sufficient. The IRS has stated that borrowers must carefully and precisely prepare their Schedule K reports, have formal written procedures for post-issuance compliance and be prepared for a challenging audit if they do not.

SCHEDULE K AUDITS

The IRS made several announcements in October 2011 as to its intent to audit certain bond issues based on its review of Schedule K filings, likely targeting those that report excessive private use, no private use or that have inconsistencies in their tax returns without a thorough explanation of the same. It appears that those hospitals and health systems that provide detailed and thorough responses and explanations on their Schedule K reports will not only be in a better position to defend themselves in the event of an audit, but also less likely to be the subject of an audit at all.

Borrowers should have processes in place to ensure that annual Schedule K reporting is accurate and thorough. Borrowers must know exactly which assets are bond-financed and need to ensure that all management and service contracts that include the use of bond-financed assets have been reviewed by qualified legal counsel.

POST ISSUANCE COMPLIANCE

Technically, there is no legal requirement that a borrower of tax-exempt bond proceeds has written post-issuance procedures. However, the IRS has been sending strong signals that it will treat borrowers that implement effective written procedures more favorably than those that do not.

The IRS has started requiring borrowers to report on Schedule K if they have written post-issuance compliance procedures in place. The IRS has also requested copies of the same within audits. On August 11, 2011, the IRS released updated administrative procedures for the tax-exempt bond Voluntary Closing Agreement Program (VCAP). The updated VCAP procedures now permit a reduced settlement amount when an organization submits a timely VCAP request following the identification of a violation using written post-issuance compliance procedures. Perhaps more importantly, the update also describes what must be included in such written procedures and provides that, generally, bond documents themselves will not qualify as written procedures for post-issuance compliance purposes.

RECOMMENDATIONS

Recent statements by the IRS as to **(1)** the availability of reduced sanctions when written post-issuance compliance procedures are in place, **(2)** its belief that all borrowers of tax-exempt debt should have written procedures and **(3)** its intent to conduct audits based on information in Schedule K filings, suggest that every health care organization with outstanding tax-exempt debt should have written post-issuance compliance procedures in place as soon as possible. Organizations that have already adopted written procedures should verify that they meet the minimum requirements provided by the IRS. ■

Strategic Use of Tax-Exempt Debt for Acquisition Finance

When acquiring a hospital or health system with outstanding tax-exempt debt, the acquirer must consider how to absorb the outstanding debt. The acquisition, however, by a 501(c)(3) hospital or health system of an entity that was previously for-profit may also create new opportunities for financing assets on a tax-exempt basis. Some considerations for each scenario are presented below.

ACQUIRING A NON-PROFIT ENTITY WITH OUTSTANDING TAX-EXEMPT DEBT

The acquirer will want to determine as soon as possible exactly what assets are bond-financed and the quality of prior bond documents. Where an acquisition target has tax-exempt bond proceeds allocated to undesirable assets or poor historical records as to what assets are bond-financed, some or all of the aquiree's tax-exempt debt may need to be redeemed rather than refinanced by the acquirer. Such a situation may well affect the economics of the acquisition.

Even in these instances, the acquiree will often have certain assets that were not financed with tax-exempt bond proceeds but are eligible for such financing. Thus, it may be possible to finance the acquisition of these assets on a tax-exempt basis, thereby gaining full advantage of tax-exempt financing opportunities.

Smaller hospitals or health systems often will require a capital commitment by the larger system as a condition of acquisition. The amount of such a capital commitment and whether all or any portion may be financed on a tax-exempt basis can also affect the economics of the acquisition.

In addition to what is legally eligible for tax-exempt financing, an acquirer will need to consider what amount of debt the health system will be able to support post-acquisition. A health system needs to work closely with its bond lawyers, financial advisors and underwriters to ensure that its debt service coverage, credit rating and interest rates are not negatively affected by an acquisition.

ACQUIRING A FOR-PROFIT ENTITY

During the past several years, hospitals and health systems have been acquiring physician practices and ancillary service centers at a breakneck pace. By virtue of their new ownership by a 501(c)(3) parent, certain assets may now be eligible for tax-exempt financing. Care, however, needs to be taken in allocating bond proceeds beyond core assets.

When considering whether or not to bond-finance any asset, the key question is, "Do I think I may ever want to sell this asset, contribute it to a joint venture or otherwise change its ownership or use?" If the answer is yes, tax-exempt bond financing may not be the best option.

Examples of physician practice and ancillary service acquisition assets that may be suitable for bond-financing are land, buildings adjacent to major hospital facilities and equipment that may be readily re-located in the event that the facility in which it is housed is sold or used for a joint venture.

Perhaps the best strategic use of tax-exempt debt for acquiring entities without outstanding tax-exempt debt is to "keep your powder dry" by bond-financing as much as possible of one's core assets. This leaves other cash available for purposes that are not eligible for or suited to tax-exempt finance. ■

Medicare Revalidation May Require Debt Disclosure

Recent revisions to the Medicare Enrollment Application (CMS-855A) may require additional disclosure from institutional providers that benefit from tax-exempt bond proceeds. Section 5 (Ownership Interest and/or Managing Control Information) requires disclosure of "[a]ll entities with at least a 5% mortgage, deed of trust or other security interest in the provider." While the instructions for Section 5 are not entirely clear, it is apparent that a provider receiving tax-exempt bond proceeds (either directly from an issuer or indirectly through an allocation from a parent organization) will need to consider such a disclosure if it granted a security interest in any of its assets (including operating revenues) in connection with a tax-exempt borrowing. The security interest percentage is calculated as the total dollar amount of the obligation secured by the provider divided by the dollar amount of the total property and assets of the provider. Because the CMS-855A must be completed by both institutional providers applying for enrollment in the Medicare program and enrolled providers when revalidating their enrollment, all providers will need to review their relevant bond documents to determine if disclosure is necessary. ■

Indiana Hospital Association Names Health Policy Leadership Award After John C. Render

On October 27, 2011, the Indiana Hospital Association (IHA) awarded John C. Render the inaugural John C. Render Award for Health Policy. The award was created and named after Render for his leadership, courage and perseverance advocating positive health policy for all Hoosiers over the past 40 years.

"John Render's impact on health care in Indiana is immeasurable," said Doug Leonard, president, IHA. "We are fortunate to have great leaders in health care, but few whose service has historically shaped the industry."

Render started working with attorney William S. Hall in 1971 to help with the increasing burdens of regulation and advocacy for the health care industry. Today, Hall Render is the second largest health care law firm in the United States, with more than 160 attorneys, serving health care industry clients throughout the country.

"There has not been a piece of health care legislation passed in the state of Indiana that has not had the touch of John Render," said Ken Stella, president emeritus, IHA. "He is tremendously respected by the state legislature and by the regulators, and they continue to seek his advice as new health care legislation is drafted."

Render is responsible for the legislation that established and/or revised reimbursement programs such as "the hospital care for the indigent program," Indiana's "Medicaid disproportionate share program" and the "Medicaid upper payment limit program." For many years, these programs have been the financial lifeblood of hospitals serving large numbers of lower income patients. It is no exaggeration to say that many communities in Indiana would be without a hospital today if not for the creative reimbursement programs that Render helped develop.

"John set a high standard for health policy leadership through his work at Hall Render and involvement with IHA," said Bill Thompson, president, Hall Render. "I know many others are, and will be, inspired by him just as I am." ■

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With more than 160 attorneys, Hall Render partners with clients to direct them through the ever-changing business landscape of today's health care industry.

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