



## THE BOND BUYER

REGIONAL NEWS

May 26, 1999

# Small Michigan Hospital Swims Against Downward Currents

By [Andrew Ward](#)

CHICAGO -- Investors who are looking for value in today's stormy health care marketplace may need to head to the country, according to some market analysts.

Some of the nation's small-town community hospitals -- like the **Memorial Healthcare Center of Owosso**, Mich. -- are doing a good job of staying in the black despite the hit that the nation's health care credits have taken from federal Medicare cutbacks and state Medicaid reforms.

In the face of a slew of hospital downgrades, **Standard & Poor's** has upgraded a few community hospitals this year, said **Liz Sweeney**, a health care analyst for the agency.

Owosso held its own last week when Standard & Poor's rated the \$14 million of hospital revenue bonds that the hospital will sell through the **Michigan State Hospital Finance Authority** early next month. The agency reaffirmed its BBB-plus rating on the hospital's debt.

Owosso even had the confidence to consider a competitive sale, which remains extremely rare in the sector. But it ultimately decided to place the bonds through the more common, negotiated process after it found it could not obtain triple-A insurance, according to financial adviser **Shelley Aronson**, president of **First River Advisory**.

That stability stands in stark contrast to many of Michigan's health care titans. Blue-chip players like the **Detroit Medical Center** and **Henry Ford Health System** have faced losses and credit downgrades in the last year. Altogether, Michigan hospitals, especially in the Detroit area, have announced almost \$250 million in losses and laid off 7,000 employees this year, said **Spencer Johnson**, president of the Michigan Health & Hospital Association.

The crisis hitting the sector is a three-headed monster, composed of state Medicaid funding cuts, federal Medicare spending cutbacks, and the continued growth of cost-conscious managed care companies, Johnson explained.

This combination has pounded the state's big urban hospitals. But two of the problems -- managed care and Medicaid -- have had little impact on the Owosso hospital.

Michigan has trimmed \$300 million from its Medicaid budget by moving poor and disabled people into managed care plans over the past two years. But the town of Owosso has almost no hard-core poverty, leaving its hospital with a small Medicaid case load, Aronson said.

Managed care has been taking over the Detroit area and cutting into hospital fees for years, and health maintenance organizations are now the norm for health plans in the region. But tiny Owosso -- which is about an hour-and-a-half drive northwest of Detroit -- advertises for doctors by pitching itself as a place where they can still practice medicine outside of the reach of managed care bureaucrats.

However, Owosso has taken it on the chin from the Medicare cuts in the Balanced Budget Act of 1997. The hospital saw \$1.6 million of revenues evaporate last year, as the federal cuts began to set in. That's a large piece of its \$68 million a year budget.

But the hospital is still in the black. It made \$2.5 million last year -- down from \$6.2 million in 1996, but still a healthy 3.6% margin. That reasonably strong earnings history and conservative debt policies have teamed up to give the hospital a solid balance sheet, according to the

Standard & Poor's rating report.

The agency also noted that Owosso is the only hospital in its market, letting it escape the head-to-head competition that has hurt Detroit's big hospitals. But it does lose a significant portion of the local business to bigger hospitals in **Flint** and **Lansing**, which are both within easy driving distance of the town, according to Standard & Poor's.

Aronson said the hospital commands an impressive 73% market share in its core area, though its market share drops off on the periphery of its region. Overall, the hospital estimates its market share at 47.5% in its target region.

The relative strength of the hospital is more apparent when one realizes that the top of the rating range for small community hospitals tends to be in the single-A category.

Sweeney said few small hospitals can muster the diversity of revenues, sophisticated management teams, and large cash flows that bolster huge systems like the AA-plus rated **Daughters of Charity National Health System**, leaving even the best of them in the single-A range.

But Owosso is getting more sophisticated, Aronson contends. He said its current deal would kick-off a new debt-management strategy. It will refinance most of its outstanding debt to stretch its debt service payments over the life of the assets being financed, and it will stop depending on medium-term loans from the state's pooled hospital loan fund to fund long-term capital needs.

Standard & Poor's called the restructuring a rating strength.

The strength even emboldened the hospital into thinking it might venture into the market on its own with a rare competitive health care deal. The plan went awry when both **Financial Security Assurance** and **Ambac Assurance Corp.** declined to insure the deal. The third insurer active in the health care sector, **MBIA Insurance Corp.**, has a policy of not backing any hospital rated less than A-minus.

The hospital is now looking to **Asset Guaranty**

**Insurance** Co. in hopes of getting coverage from the double-A-rated insurer. It expects to get a decision any day now.

Regardless of the outcome of its insurance negotiations, the deal will be sold as a negotiated issue led by **Comerica Securities** and co-managed by **A.G. Edwards & Sons Inc.**

Aronson considered the competitive deal in hopes of getting better rates for the hospital. But when the prospect of triple-A rated insurance fell through, Aronson said he "didn't quite have the courage to bring a triple- B-rated hospital to market competitively."

Most hospitals -- especially those in the triple-B range -- sell their deals through negotiation because they are "story bonds" that take quite a bit of explaining to make investors comfortable, according to **James Faherty**, a managing director at the health care boutique **Shattuck Hammond Partners**. They sell well, even in today's worrisome health care market, but they take some explaining, he says.

Aronson, who has been a financial adviser to small hospitals for years, also thinks they're good buys -- especially this one.

"Somehow this myth got started that if you can't get insurance, you're a bum," he said. "That's baloney. I've been in this business since 1979. I've never done an insured deal. And in all those years, I've only had one deal rated as high as single-A."

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