Ascension Readies Big Sale
$1.55B Refunding Deal Heavy on Auction Rates

Posted 02/25/03

By Yvette Shields

CHICAGO - Over the next two weeks, St. Louis-based **Ascension Health** Inc. will bring $1.35 billion of auction-rate securities to market - the most ever for the health care sector - as part of an overall $1.55 billion refinancing deal that will sell through five issuers and includes a synthetic fixed-rate swap.

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Though officials from the nation's largest nonprofit health care system had several goals in mind when structuring the complex deal with their financial team, the primary mission was to save money without adding credit risk.

"The savings was the big consideration," said **Stephen Gilmore**, debt manager at Ascension, who estimates a present-value savings level of $125 million, or 8%.

The deal also accomplishes the conversion of $264 million of taxable commercial paper, issued late last year to close Ascension's acquisition of St. Louis-based **Carondelet Health System**, to a long-term financing structure. It also smoothes out the system's debt service payments over the next three decades.

In addition to retiring the taxable commercial paper, the upcoming transaction, along with a $128 million cash contribution, will reimburse the system for $128 million worth of capital projects and will refund nearly $1.1 billion of outstanding debt issued since 1999.

Ascension is returning to the market with a refunding nearly three months after it resolved an Internal Revenue Service audit of a piece of its acquisition financing transaction back in 1999. The system agreed to pay the federal government $2.7 million to resolve the examination of $575 million in acquisition financing bonds sold as part of a larger transaction that created Ascension - **Daughters of Charity** merged with the **Sisters of St. Joseph of Nazareth** to create the system.

The highly-rated system, which operates in 20 states, is using five issuers to sell its debt. The first piece, an uninsured fixed-rate series for $210 million, will sell on Tuesday through the **Escambia County, Fla., Health Facilities Authority**.

The auction-rate securities will sell the following Thursday, March 6, and

Tuesday, March 11, with $525.4 million through the **Michigan State Hospital Finance Authority**, $295 million through the **Missouri Health and Education Facilities Authority**, $24.7 million through the **Idaho Health Facilities Authority**, and $498 million through the **Indiana Health Facility Financing Authority**.

Orrick, Herrington & Sutcliffe is bond counsel.

Morgan Stanley and **Salomon Smith Barney** Inc. are co-senior managers, re-marketing agents, and the counterparties in the deal. Ascension opted for a forward swap contract to eliminate the risk of interest rate fluctuations. Ascension will pay a fixed rate that totals 4.19% with various fees included. **Kaufman Hall & Associates** Inc. is Ascension's financial adviser.

All but $290 million of the auction-rate debt will carry triple-A insurance in nearly equal amounts divided between **MBIA Insurance** Corp. and **Ambac Assurance** Corp. Though a good portion of auction-rate debt is often marketed without insurance, Ascension decided to go with insurance on an amount of refunding bonds equal to the amount of triple-A insured bonds being refunded. Officials couldn't say if capacity among the insurers was an issue because "we never asked for more capacity," said Salomon health care banker **Jim Blake**.

The deal marks Ascension's second employment of the auction-rate structure. Last summer, it sold $200 million of auction-rate debt. At that time, Ascension turned to the structure because it allowed the system to capture the lower interest rates associated with floating-rate debt without the need for liquidity support, there being no put risk with auction securities. At the same time that Ascension's deal came during the summer, another large Missouri-based health care system, **SSM Health Care**, also launched its inaugural use of the auction-rate mode.

More health care borrowers with sturdy credits are turning to the mode, according to Blake and other market participants. The structure benefits borrowers in strong double-A territory and those that are able to obtain triple-A insurance, because the number of liquidity providers - especially those willing to provide support for health care credits - has shrunk over the last several years.. As a result, the cost of liquidity has been pushed up. Many contracts also must be renewed annually, compared to longer terms in the past, and that presents administrative headaches for borrowers.

"Five years ago there were a lot of banks providing liquidity," Blake said. "The auction market is also more recent ... health care [systems] are also looking at a broader array" of debt products.

Though the deal is hefty in size, after the initial pricing finance officials will stagger the auction periods, spreading tranches out over a five-week period. Several market participants said the auction-rate market would easily absorb the deal.

The system could not have capitalized on the variable-rate market if not for the opportunity to lock in a synthetic fixed -rate, because it would have added too much variable-rate risk to the system's debt portfolio. Once the deal is completed, the system will carry about 40% floating rate debt and 60% fixed, including the synthetically fixed debt.

The swap is based on a percentage of the taxable London Interbank Offered Rate benchmark. Market analysts have begun to raise concerns regarding the risks associated with Libor-based swaps. The spreads between Libor and tax-exempt rates have grown exceptionally tight of late and that has cut into the overall savings borrowers gain by using the benchmark, with some even suffering short-term losses. Investment bankers who market the swaps to borrowers have responded by increasing the percentage of Libor paid or by lowering the amount and tacking on additional percentage points.

The tightness has resulted in losses for issuers who receive a rate from their swap counterparties, usually somewhere between 60 and 70% of Libor. Many borrowers are willing to absorb the tax risks associated with Libor because the savings it generates are greater than if the swap were based on The Bond Market Association municipal swap index.

Ascension's chief financial officer, **Tony Speranzo**, said the swap includes modifications so that the counterparties will pay some amount in addition to a percentage of Libor. "We think it's the right type of hedge," Speranzo said of the swap contract, the health care giant's first. "We studied this transaction for well over three months. We think we have taken a conservative approach."

"Fitch has analyzed the swap agreements and believes risks related to the swap are nominal," according to a **Fitch Ratings** report on Ascension.

The three major rating agencies this week affirmed their mid-level, double-A ratings on Ascension's $3.6 billion of outstanding variable-rate and fixed-rate debt. Ascension, among the top-rated health care credits that are rated by all three major rating agencies, has recorded improvements in operations in each of the last three years, and its income levels were stable last year despite the acquisition of Carondelet and its nine hospitals.

Despite its strengths, though, the system faces the same mounting pressures confronting the sector, such as poor investment results and rapidly growing pension and insurance costs which, "if not checked over the next few years, could sharply pressure Ascension Health's improved operating performance," according to Standard & Poor's.

In addition to the cost savings, the upcoming transaction will level out the system's debt service, which absorbed some peaks and valleys when it acquired Carondelet's nearly $300 million of debt - much of which was front-loaded with repayment completed within 20 years. In order to level out its debt service, Ascension will end up pushing out further repayment of some of that debt as it is incorporated into the system's overall debt repayment structure.

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