Ascension's New Lien

By Yvette Shields, *The Bond Buyer*

CHICAGO, Jan. 19 -- In a deal ultimately aimed at reducing its pension liability, St. Louis-based Ascension Health today will sell $625 million of medium-term, new-money bonds in a complex tax-exempt transaction that establishes a new subordinated lien in the system's overall debt portfolio of $4.1 billion.

The bonds will sell through the Alabama Special Care Facilities Financing Authority, the Indiana Health Facility Financing Authority, and the Michigan State Hospital Finance Authority.

Citigroup Global Markets Inc. and Morgan Stanley will be co-senior managers and Orrick, Herrington & Sutcliffe LLP is bond counsel.

The new bonds are an unsecured general obligation of Ascension's obligated group, the identical pledge assigned to the system's existing $3.5 billion of debt. At the same time, Ascension will give its outstanding bonds senior-lien status and attach a secured revenue pledge to those bonds.

The use of a senior-subordinated structure, while common in the corporate world and in various governmental revenue bond sectors such as transportation, is a rarity in the not-for-profit health care sector, according to market participants.

The bonds are structured in a serial mode with purchase dates between 2005 and 2012. Ascension retains the option as of the purchase dates to either redeem the securities or to reissue them using the same structure or a new one.

Ascension also plans to convert the fixed-rate bonds to a synthetic floating rate in a swap with counterparties Citigroup and Morgan Stanley based on The Bond Market Association index, according to Ascension debt manager Stephen Gilmore.

The bonds have received ratings of AA-minus from Fitch Ratings and Standard & Poor's and Aa3 from Moody's Investors Service, one notch lower than the agencies assign to the nation's largest nonprofit health care system's existing debt.

Ascension will use the bulk of the proceeds to reimburse itself for recent capital projects that qualify for tax-exempt financing, said chief financial officer Anthony Speranzo. The health system will deposit the proceeds into its cash and investment fund and then in turn withdraw $650 million to reduce its nearly $1.4 billion unfunded pension liability.

It was the Ascension board's decision to address the pension liability that drove the creation of the new subordinated pledge. Ascension's pension liability is a softer one than a debt service payment owed to investors and the system has quite a bit of flexibility in

dealing with the liability because its pension plan falls under the category of church-based programs not subject to the Employment Retirement Income Security Act of 1974, which sets strict funding standards in private industry. Ascension considered several options, including the possible issuance of some type of preferred stock, but opted in the end to tap its cash account after issuing debt to reimburse itself for capital costs.

In moving its existing debt to a senior-lien status, Ascension officials will now secure the debt with certain revenues, a move that adds a new, sturdier layer of protection to the debt. The newly secured senior-lien credit will also be registered in compliance with the federal Uniform Commercial Code's requirements for perfecting a security. The new, subordinated master indenture mirrors the original indenture that previously was applied to all of Ascension's debt.

The thinking was that we wanted to have a major impact on our pension program, Speranzo said. And as we looked at our capital structure, we felt that because we have a lot of flexibility in the way we can deal with the pension liability, putting a subordinate master trust indenture was more appropriate and fair for our current bondholders.

Putting the new debt on par with our existing debt wouldn't be fair to our current bondholders, he added. We think our current investors will view this pretty positively. The system expects to eliminate its pension liability within 10 years.

Ascension officials and their bankers hosted an investor call last Thursday in which dozens of investors participated, a number far in excess of those who participated in calls held for previous Ascension deals.

Citigroup health care banker James Blake said he suspects it was both interest in the new debt and current bondholders curious about how their holdings would be affected that fueled the interest. Many people on the call wanted to hear about the senior/subordinate structure, he said.

Ascension has about $10 billion in revenues from its 63 acute care hospitals and 12 specialty hospitals operating in 20 states and the District of Columbia in fiscal 2004.

This transaction could mark the path for other health care issuers, although it is unclear whether there will be a demand for senior-subordinate structures. In Ascension's case, the decision was based on a specific, pension-related need.

This is pretty rare and it's possible that Ascension has paved the way, said Fitch's John Wells. Not a lot of [higher-rated] health care credits have secured debt outstanding, but it remains to be seen whether there will be a need to do this.

The deal today is Ascension's first since March 2003, when it entered the market with another complex one a $1.55 billion restructuring that included $1.35 billion of auction-rate securities and a synthetic fixed-rate swap. The deal priced over three days through five conduits.

Ascension had its eye on saving money without adding credit risk in that deal, and similar goals influenced the structure officials eventually adopted for the deal today. Because the system's debt portfolio is a mix of fixed-, auction-, and floating-rate securities and contains several swaps, no structure is foreign.

The finance team flirted with several ideas including the use of index put bonds. They settled last week on the serial bond structure with a final purchase date limited to 2012, a position on the yield curve officials believed would capture the best interest rates.

The serial mode was chosen for the flexibility it affords Ascension in managing the repayment of its overall debt portfolio.

We wanted a flexible structure so that as we realize the benefits of making the pension payment up front, we have the flexibility to turn around and reissue the bonds in the same mode or a different mode or to pay them off, Speranzo said. If Ascension sees a strong return on pension investments, it future payments could be reduced providing more cash to repay the bonds.

With the upcoming transaction, Ascension's mix of fixed to floating-rate debt will move to a 47% to 53% match compared to the current 57% to 43%. The new debt is being treated as floating rate because of the swap to a synthetic variable rate, according to Gilmore.

Ascension was created by the 1999 merger of the Daughters of Charity and the Sisters of St. Joseph of Nazareth. Its regional diversification is a credit strength since it doesn't rely on any one facility for a high percentage of its revenues, according to Standard & Poor's.

However, some concentration of risk does exist within regions where numerous facilities are maintained, the agency said. Despite those challenges and sizable operating losses in different markets over the last few years, the system has grown cash flow six consecutive audited years.

Ascension's capital program is expected to spike in upcoming years with spending of between $800 million and $1 billion annually over the next five years, compared to an annual average of $600 million over the last five years. About $350 million total will be financed with borrowing.

Ascension should be able to manage these levels without using cash, provided operating cash flow levels remain strong, Moody's said.