Innovative Ascension: Deal Includes $311M Private Placement

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by Matthew Hanson and Matthew Posner

MMA's Matt Fabian
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The complex swaps and moving parts on Ascension Health's recent bond sale, coupled with a last-minute audible to place part of it privately, highlights the growing sophistication of today's municipal issuers, say market participants.

The nonprofit health care giant tomorrow will close on more than $912 million of debt it priced Nov. 2. The company was prepared to sell either fixed-rate or variable-rate bonds, waiting until just before the sale to settle on the exact structure.

Remaining nimble allowed Ascension to take full advantage of market conditions just one day after MMD charted its lowest rates in history.

"This issuer is as market-savvy as you will find in the muni market," said a New York derivatives analyst not involved in the deal "These guys waited 'til the last second, ran through the numbers, and took advantage of letting markets compete against each other."

The plan laid out in preliminary bond documents said Ascension would sell $917.9 million of fixed-rate debt and then swap some or all of it for floating rates.

"We try to diversify the debt portfolio," said Steve Gilmore, Ascension's assistant treasurer. "So we don't try to load up on any particular instrument, whether it be auction rate, or serial mode, or synthetic variable."

The finance team stayed loose, though, so they could use flexibility to the system's advantage by adjusting to changes in the market before the deal sold, Gilmore said.

"We went out with a $900 million POS, and we kind of had all plans of attack covered," he said. "We knew that we might do a portion of the deal with a different structure, and that's what we ended up doing."

On pricing day, only $601.2 million was sold through the four planned conduits. All of that portion was sold at fixed rates, and then about $315 million of it was swapped for floating rates based on the swap index maintained by The Securities Industry and Financial Markets Association, formerly the Bond Market Association.

An additional $311 million was then sold directly to Morgan Stanley and Citigroup Investment Banking, the two underwriters on the deal. These bonds also carried variable rates and were split about evenly between the two banks, said John Landers, a managing director at Morgan Stanley and a lead banker on the deal. Citigroup bankers declined to comment on the multipart transaction.

MULTISTATE CONDUITS

St. Louis-based Ascension is the parent of the nation's largest nonprofit Catholic health care system, including 104 operations in 20 states and Washington, D.C. As such, the company has relationships with conduit issuers in nearly as many states — from Missouri, to Connecticut, to Florida, to Idaho.

So for the nationwide health care company, part of the finesse of doing a large bond sale involves calling on several conduits to participate in the deal.

"Ascension wants to continue to keep those good relationships, and issuing it all through one authority would not accomplish that," Landers said.

The Wisconsin Health and Educational Facilities Authority issued $118.8 million of the deal, earmarked mostly for construction of a new hospital on Milwaukee's east side, according to the official statement.

The Indiana Health and Educational Facility Financing Authority sold about $286.7 million, and its share went to refunding some of Ascension's debt. Its share of the private placement will finance projects in Indiana, Tennessee, and Texas.

A frequent partner in Ascension's debt sales, the Indiana authority is allowed under state law to issue debt for use in other states as long as the proceeds also provide a substantial benefit to an Indiana health care facility, said Dan Kramer, the Indiana conduit's executive director.

"We're helping to benefit the citizens of Indiana when we do one of these multistates — just because we are involved in a substantial percentage," Kramer said. He added that his authority has issued Ascension debt in six of the past seven years.

The remaining fixed-rate bonds were sold by two Alabama special care facilities financing authorities, one based in Birmingham, and the other in Mobile. The two sold $95.1 million and $100.6 million, respectively — both to refund past debt.

Packaging all these parts together into one debt sale helps build up the size of the deal and get the attention of the country's largest institutional buyers. It also helps simplify what could quickly become an overwhelming process.

"We've got a lot of attorneys and we're just motivated to get the whole thing done and closed at the same time," Gilmore said. "The more we break it up, the more it adds complexity to the transaction."

PRIVATE PLACEMENT

While details of the swaps remained in flux until pricing day, the biggest change was that $311 million was sold as a private placement. Nearly a third of the total par was pulled from the market and set aside for the deal's two underwriters.

"In our collective markets, for a lot of our better credits, they're going to want us to put some balance sheet at risk, and this is a way that our two firms could do that," Landers said. The private placement, along with the original fixed-rate bonds, will close on Thursday, he added.

By itself, this share is the second largest private placement in the municipal market so far this year, according to Thomson Financial. The private portion will be enhanced index put bonds, pegged to certain indexes and then swapped to SIFMA-based rates. About $276.3 million will come through the Indiana conduit, and the Birmingham authority will sell the remaining $35 million.

Ascension is no newcomer to interest rate swaps, either. The health system's company has swaps on roughly $2.1 billion worth of debt and expects that the 2006 Series bonds will eventually result in another $944 million, according to the official statement.

MARKET CONDITIONS

On the day of the Ascension pricing, which had maturities between 25 years and 33 years, Market Municipal Data's 30-year AAA General Obligation bond index yielded 4.05%, only a slight increase from the all-time low of 4.02% set on Nov. 1.

To put this into perspective, this same MMD index yielded 4.14% on Oct. 30, and reached 4.13% by Nov. 3.

"They came to market at one of the best possible times, this is the type of fixed rate issuers die for," said a trader in Chicago, who has bought and sold Ascension bonds since the sale.

Taking into account all four series within the Ascension umbrella, yields ranged from 4.33% with a 5% coupon in 2031 to 4.40% with a 5% coupon in 2039. Compared with MMD's AAA yield curve on Nov. 2, the bonds maturing in 2031 and in 2036 were 32 basis points over. The curve does not extend out to 2039.

A large portion of the variable-rate debt was tied to the SIFMA index. On the week of Nov. 1, the seven-day SIFMA index was set at 3.39%, a significant drop from the week earlier, which was set at 3.56%.

On the day of pricing, the SIFMA 30-year swap rate fell to 3.93%, after a series of declines from a week earlier when this rate reached 4.06%. The day following the deal, the swap ratio jumped back to 4.01%.

Some market participants saw this Ascension deal, the largest of the week of Oct. 31, as a key reason for the sinking, and the subsequent rising of the SIFMA index.

"We had that big Ascension health care deal and all the swaps related to that deal that pulled [SIFMA] south, and then back up after everyone realized the market had gone too far down," said Matt Fabian, senior analyst for Municipal Market Advisors. "The [SIFMA] index has taken on a stronger role with the increase in crossovers and hedge funds, and when big deals like this come to market that are playing heavily in that space, you are going to get a big effect."

Bankers on the deal said there are too many factors affecting the SIFMA curve to be sure their deal alone moved the market.

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