ZIEGLER CAPITAL MARKETS | SENIOR LIVING FINANCE
Z-NEWS

IS THIS *REALLY* A THAWING IN THE CAPITAL MARKETS?

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A host of indices and statistics seems to impact the capital markets. Sometimes such data, like last week's slightly-less-grim-than-expected jobless report, can yield inexplicable results such as a burst of (sometimes unwarranted) enthusiasm in the stock market.

As we explained in a ***Z-News*** earlier this year (Z-News 3/13/09), the influencers of long-term fixed rates for senior living borrowing are a bit more predictable (we encourage readers to reference that more detailed explanation of the factors affecting these rates). Thankfully, these influencers have stabilized since year-end.

Briefly, the primary determinant of long-term fixed rates for senior living borrowers is the level of interest rates for the safest, "AAA"-rated tax-exempt municipal bonds. All municipal bonds are priced off of this theoretical baseline, the most common practical index for which is Municipal Market Data's AAA Index (MMD). (Of course, even this baseline rate isn't set in a vacuum; it is affected by Treasury yields, tax policies, market supply and demand, etc.) After moving upward from historic lows in late 2006 and spiking in late 2008, MMD currently stands at just over 4.75%, which is well below its modern-era average and right on top of its ten-year average. We are encouraged by its relatively stable performance since the beginning of the year, despite some upward pressure over the past several days.

A second primary driver of senior living interest rates is the perception of credit risk in the market and the cost of that credit. In difficult economic times, the credit risk posed by nearly every industry, company and borrower increases. For many senior living borrowers, the housing-focused nature of this recession has added pressure on their credit appeal. Actively-traded high yield corporate bond indices provide real-time information on how markets are assessing and pricing credit risk: these markets are larger and more liquid than the senior living market and their movements can be a good predictor of trends in the smaller high-yield municipal market. With the 30-year Treasury bond yielding roughly 4.60%, a high yield corporate bond is yielding approximately 1000 bps more, or 14.60%! While still large, this spread over the Treasury bond has retreated significantly from its 2000 bps level of late 2008.

Supply and demand also affect borrowers' yields. Too much supply and bonds' prices are forced downward (and, consequently, yields move up). In late 2008, tremendous supply in the secondary market was the real culprit in forcing prices downward and yields upward. Heavy, 'forced' selling by municipal bond funds raising cash for redemptions flooded the market with bonds. But, as we noted in the earlier ***Z-News***, this secondary market supply has once again become manageable as we've seen a rebound in municipal bond demand. High yield municipal bonds are purchased by individual investors, asset managers, hedge funds, banks, insurance companies and — in largest part — by high yield municipal bond mutual funds.

Focusing on this latter group, the volume of bonds these funds can purchase is directly related to the amount of cash flowing in and out of the funds. In the final quarter of 2008, several factors prompted huge cash flows out of municipal bond funds, but today high yield municipal bond portfolio returns have been strong year-to-date, and demand from retail investors purchasing individual bonds has been a big plus to the market. For nearly 23 weeks in a row, the supply of dollars flowing INTO municipal bond funds has been strong and steady. Together, all of these indicators — stronger demand, manageable supply, improving perceptions of credit and reasonable baseline interest rates — have led to an improving outlook for healthcare and senior living borrowing rates.

We can, meanwhile, look to the experience of more than a dozen hospital credits that have issued bonds in the markets in the past two months, realizing increasingly lower yields. In late December, "A"-rated hospitals came to market at 8.50% yields, in January at 7.50% yields but, this week, with Ziegler's pricing of $300 million for Adventist Health System, this "A+"-rated credit realized yields below 6%. In addition, three fixed rate senior living transactions have been priced so far this year. The two most recent "A"-category senior living system borrowers — ACTS Retirement-Life Communities and Evangelical Lutheran Good Samaritan Society — were priced with encouraging long-term yields of 6.25% to 7.25%. In secondary senior living trading, we are seeing more trades between 9.0% and 10.0%, and fewer trades yielding above 10.0% or 11.0%, as was the case in December.

On June 17 Ziegler will be hosting approximately 25 of the most active institutional investors from these high-yield municipal bond funds for a period of discussion on their current perspectives. We look forward to highlighting the views from Ziegler's Institutional Investor Workshop in a near-future ***Z-News***.

*Ziegler Trading & Underwriting publishes a list of current senior living borrowing rates each week that can be found linked to your **Z-News** email. For more information on the topics discussed in this article, please contact the Ziegler banker in your area.*

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