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Providers keep borrowing while the borrowing's good, fearing higher rates

By Beth Kutscher | December 26, 2014

Expectations that the Federal Reserve could raise interest rates in the new year have healthcare financial managers rushing to lock in attractive rates while the debt markets are still favorable for them.

The rate-setting Federal Open Market Committee attempted to reassure the market this month that it believes the current rate is appropriate for now.

But it also noted in a news release that it would closely watch employment and inflation levels in deciding whether to raise the federal funds rate from its current 0 to 0.25% target range. The recent upward revision of third-quarter gross domestic product growth to 5%, the most robust in 11 years, is further fueling speculation that the fed will act sooner rather than later in raising rates.

Historically low interest rates have revved up the healthcare lending markets over the past year, providing capital for new projects and sending M&A deal value to new heights.

“There are a lot more deals going on,” said Rob Harris, a Nashville-based financing attorney at law firm Waller, who primarily works with for-profit healthcare organizations. “We’ve been very busy since Labor Day.”

Not-for-profit health systems have been focused on refinancings in the fourth quarter, said Roger Strode, a Chicago-based transactions attorney at Foley & Lardner. As an example, he has seen newly merged health systems that initially decided to maintain the legacy parties’ separate obligated groups rather than risk early payoff fees now becoming a single obligated group.

“I think there’s a rush in anticipation because money is cheap,” he said. Even with early payoff fees, “it’s worth doing because the interest rates are so low.”

Even if rates do rise, however, merger and acquisitions activity should remain brisk in 2015 because of the strategic rationale behind gaining size and scale.

Not everyone is expecting higher rates in 2015. Steve Kennedy, a managing director at healthcare investment bank Lancaster Pollard, said he doesn’t see much evidence that rates will rise any time soon. “There’s not this crazy sense that deals should be closed now or never,” he said.

A small increase in interest rates would have a negligible effect on the strongest healthcare organizations but could put pressure on financially weaker providers with variable rate debt.

“Even a half a point bump might have a grave effect,” said Mark Claster, president of Carl Marks & Co., which provides investment and advisory services. Those providers could then be forced to find partners.

While Claster did not expect rising interest rates to have a chilling effect on financing activity, he agreed that some organizations could be moving to build cash reserves while lenders are eager to lend. “If you’re going to be spending this money over the next 12 months, you might as well raise money now,” he said.

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