Trends in NCMCC Bond Financings Since 2008

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NCMCC Bond Issues Before 2008

- Before 2008, almost all NCMCC bond issues were publicly offered in one of three forms:
  - fixed rate bonds, which in some cases were insured by a bond insurer,
  - variable rate demand bonds ("VRDBs"), which were supported by a credit facility (bond insurance or a bank direct-pay letter of credit) and/or a liquidity facility (a bank standby bond purchase agreement), or
  - auction rate securities ("ARS"), which were always insured by a bond insurer.
- Many of the NCMCC variable rate bond issues (VRDBs and ARS) were hedged with interest rate swaps, pursuant to which the borrower paid a fixed rate and received a variable rate (usually LIBOR-based).
- Because of the bank-qualification rules that were added to the Internal Revenue Code in 1986, banks did not directly purchase NCMCC bonds from 1986 to 2008.

Trends in North Carolina Medical Care Commission Bond Financings Since 2008

- In February 2008, the auction rate securities market collapsed because of concerns about impending downgrades of bond insurers that led the broker-dealers to stop supporting the auctions. North Carolina health systems were forced to refinance their auction rate bonds, which they were able to accomplish by early 2009.
- Since 2008, as a result of the downgrades of all bond insurers, there has been almost no use of bond insurance by North Carolina nonprofit healthcare borrowers.
- Bank direct purchases of NCMCC bonds began in September 2009, initially as a result of temporary changes in the bank-qualification rules for 2009 and 2010 made pursuant to the American Recovery and Reinvestment Act ("ARRA"). Since then,
  - banks have directly purchased 64 series of NCMCC bonds totaling $2.125 billion in principal amount, and
  - almost all publicly offered NCMCC bonds have been fixed rate bonds.
- Contrary to market practices prior to 2009, banks have continued to be willing to purchase NCMCC bonds on a non-bank-qualified basis after the ARRA provisions expired on December 31, 2010.

North Carolina Medical Care Commission Publicly Offered Bond Issues

	2009 (Number of Series/ Principal in Millions)	2010 (Number of Series/ Principal in Millions)	2011 (Number of Series/ Principal in Millions)	2012 (Number of Series/ Principal in Millions)	2013 (Number of Series/ Principal in Millions)	Total (Number of Series/ Principal in Millions)
Fixed Rate	4/ 450	9/ 1,038	4/ 157	10/ 1,236	4/ 224	31/ 3,105
VRDBs	9/ 414	-	-	-	-	9/ 414
Other Variable Rate	-	-	1/ 48	1/ 59	-	2/ 107
Total	13/ 864	9/ 1,038	5/ 205	11/ 1,295	4/ 224	42/ 3,626

- After 2009, no new VRDBs, and only one Window VRDB issue and one Floating Rate Note ("FRN") issue, have been publicly offered.
- Of the 31 fixed rate series issued in 2009-2013, 18 of those series, totaling $2.691 billion, have been issued for health systems.
- There were no additional publicly offered bond issues during the first half of 2014.

North Carolina Medical Care Commission Bank Direct-Purchase Bond Issues

	2009 (Number of Series/ Principal in Millions)	2010 (Number of Series/ Principal in Millions)	2011 (Number of Series/ Principal in Millions)	2012 (Number of Series/ Principal in Millions)	2013 (Number of Series/ Principal in Millions)	Total (Number of Series/ Principal in Millions)
Health Systems	1/ 41	1/ 30	10/ 511	7/ 479	5/ 344	24/ 1,405
Hospitals	1/ 10	1/ 22	4/ 71	1/ 23	1/ 45	8/ 171
Retirement Facilities/ Hospices	6/ 124	17/ 257	3/ 46	4/ 89	2/ 33	32/ 549
Total	8/ 175	19/ 309	17/ 628	12/ 591	8/ 422	64/ 2,125

- During the first half of 2014, the NCMCC approved extensions of the holding periods for, and changes in the interest rates on, eight outstanding series of bank direct-purchase bonds, but did not issue any new bank direct-purchase bonds.

Observations About NCMCC Bank Direct-Purchases

- Of the 64 series that have been directly purchased by banks, 55 of them bear interest at a percentage of LIBOR plus a fixed spread. One series bears interest at the SIFMA Index plus a fixed spread and the remaining eight series bear interest at fixed rates.
  - In many cases the use of a LIBOR-based bond interest rate creates a perfect hedge with an existing or new LIBOR-based interest rate swap.
- Many of the direct purchases are refundings/conversions of existing VRDBs.
  - Example: In 2011 and 2012, Duke Health converted all eight series of its variable rate bonds ($516 million) into bank purchases, with holding periods ranging from seven years to final maturity (sixteen years).
- Because the bank that has been providing an LOC or SBPA for an existing VRDB is often the bank purchaser, the terms of many direct purchases have been substantially the same as the bank LOC reimbursement agreements or SBPAS they replace.
  - To make document review more efficient, a comparison of the continuing covenant agreement in a direct purchase against the existing LOC reimbursement agreement or SBPA is often distributed to the working group to highlight whether any changes in covenants or events of default have been made.

Future of Bank Direct Purchases/VRDBs

- From 1986 through 2008, banks rarely invested in non-bank-qualified obligations, presumably because the loss of their ability to deduct the carrying cost did not make the pricing of the product competitive for borrowers and/or attractive to lenders.
- Assuming that loan/deposit rates rise back to historical levels, will banks continue to be willing to invest in non-bank-qualified obligations?
- If the SIFMA Index rises back to historical levels, one would expect substantial inflows into municipal money market funds. Unless VRDB issuance ramps back up, how will the demand of municipal MMFs for suitable investments be met?

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Questions?

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