

THE BOND BUYER

Iowa hospital's 'financial freefall' sparks move to seek receiver

By

Karen Pierog

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Financial woes at an Iowa hospital led a major bondholder and a bond trustee to state court seeking the appointment of a receiver for the facility, while they demand the immediate payment of principal and interest in the wake of default events.

The move comes as hospitals nationwide [face persistent pressures](#) as they slowly recover from inflationary, supply side, and labor cost hits that dragged down margins last year.

The petition filed in Iowa's Johnson County District Court July 24 by Preston Hollow Community Capital, the sole owner of the hospital's 2018 bonds, and Computershare Trust Company in its role as master trustee and bond trustee for the 2018 debt, [pointed to events of default, financial distress, and acute illiquidity](#) on the part of Mercy Hospital in Iowa City.



The hospital and its managers found "many of Preston Hollow's threats, statements, and actions to be harmful to Mercy Iowa City," wrote Chief Restructuring Officer Mark Toney.

ToneyKorf Partners

"Given the borrower's exigent financial circumstances, and the board's refusal to act, the plaintiffs believe that a receiver must be appointed on an emergency basis in order to protect and preserve the bondholders' collateral interests, and also to ensure that the hospital remains operational for the safety and care of its patients," the petition stated.

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It pointed to a "financial freefall" in which the hospital's liquidity declined by 51.5% or about \$40 million over the past nine months, while burning through about \$2.6 million in cash per month amid a projection that liquidity will fall to less than \$5 million by Sept. 29.

"The borrower is balance sheet insolvent and unable to pay its debts as they become due, including the principal and interest payments due in respect of its \$62 million senior secured bonds and its \$40 million in defined benefit pension plan liabilities," the petition said.

The hospital, which sold \$44.6 million of health facilities revenue bonds through the city of Hills, Iowa, in 2011, followed by \$41.76 million of unrated bonds in 2018, denied there were any default events and said it was current on all of its debt service payments.

Hills is a community of 863 residents about eight miles south of Iowa City.

"Our board and management team have tried to work collaboratively with Preston Hollow on many fronts, but have found many of Preston Hollow's threats, statements, and actions to be harmful to Mercy Iowa City," Mark Toney, the hospital's chief restructuring officer, said in a statement.

Mercy said it was blindsided by the receivership move, claiming Preston Hollow canceled an in-person meeting that had been scheduled last week.

"We are deeply disappointed by Preston Hollow's actions when we have taken many steps to improve our finances and kept them informed and involved with our day-to-day operations and strategies," Toney said.

A hearing date on the receivership petition has not yet been set. The petition requests the court appoint Peter Chadwick of global consulting firm Berkeley Research Group, LLC, as receiver, noting his specialty of working with underperforming and financially distressed healthcare providers.

The bond trustee [posted notices of default](#) July 19 on the Municipal Securities Rulemaking Board's EMMA website that included the hospital's failure to comply with certain financial covenants under the master trust indenture and other bond documents and its "inability" to pay prospective debt service.

Mercy countered [with its own disclosure](#) posting on July 21 of its attorney's response, which contended no events of default had occurred.

"We encourage the bondholder parties to re-engage in a constructive dialogue regarding strengthening (Mercy's) balance sheet and avoid taking actions that may erode value and trust between the parties," the attorney's letter said.

In a July 24 notice to the hospital, Computershare Trust and Preston Hollow declared principal and unpaid accrued interest on all outstanding bonds under the master trust indenture "immediately due and payable."

The original A2 rating on the 2011 bonds from Moody's Investors Service has plummeted, falling last week to Caa3, which is still two notches above the default level, after being cut to Caa1 from B1 in May, and it remains on review for a possible downgrade deeper into junk.

The rating agency cited "a heightened risk of (debt) acceleration and the potential for weaker recovery on bonds because of continued cash burn at the hospital."



The Mercy Iowa City hospital has become the subject of a legal fight between its new management and its primary bondholder.

Mercy Iowa City

"The action also reflects significant uncertainty around the degree of financial deterioration at the hospital, and a dispute with the largest bondholder who has petitioned for the appointment of a receiver and acceleration of the debt," it added in a report.

Moody's said its review for a further downgrade will focus on the resolution in court of the petition, along with the hospital's operating and financial results as of June 30, 2023, and its updated financial forecasts.

In a July 26 statement, Mercy, which had a new management team in place April 3, said it wasn't surprised by the downgrade given Preston Hollow's public statements.

In its May rating downgrade report, Moody's said the hospital suffered severe operating cash flow losses in fiscal years 2022 and 2023 and that pressures from high labor costs and inflation, which led to a flat to declining revenue base, "will make it extraordinarily challenging for Mercy to restore margins."

"Mercy's operating loss through six months of FY 2023 was \$21 million, or a minus-24% operating margin, following a minus-20% operating margin in FY 2022," the report said.

"An upgrade is unlikely at this time given the risk of bankruptcy or debt acceleration, the severity of cash flow burn and other liquidity pressures," Moody's wrote in its July 26 downgrade report.

The 2011 bonds were sold to finance a construction, expansion, and renovation project, according to the official statement. There was no official statement posted on EMMA for the 2018 bonds.

The 2011 bonds lost their investment grade rating in 2017, when Moody's cut them from B1 from Baa2.

Services provided by Mercy, which was founded in 1873, include emergency, heart, orthopedic, maternity, and cancer care, as well as general surgery. The hospital [has 194 acute care beds](#) and a medical staff of more than 250 doctors and providers and competes with the much larger University of Iowa Hospitals and Clinics in Iowa City.

Municipal Market Analytics included Mercy's bonds in its database for new impairments despite the dispute. Other recent Midwest-based entries include UC Health at the University of Cincinnati, which will miss a fiscal 2023 debt service coverage ratio target, as well as a payment default by Northfield Hospital and Clinics in Minnesota.

While acute labor stress due to the COVID-19 pandemic has abated for non-profit hospitals, the budgetary aftershocks will continue for years, suppressing operating results through at least 2024, Moody's said in a July healthcare quarterly report.

"Hospitals are benefiting from some expense relief as staffing has become easier and the need to use pricey contract labor has decreased," the report said. "But it will take time for improved margins to follow and labor issues will remain an underlying sector challenge."