Healthcare Reform: Healthy for Munis?

May 9, 2017

by Joseph Rosenblum

of AllianceBernstein

It's hard to say how healthcare reform will affect the broad municipal bond market. But any new law with the potential to cause millions to lose insurance would be a bitter pill for hospitals. Investors should tread carefully.

For now, the biggest problem with healthcare reform for investors is the uncertainty surrounding it. The passage of a bill in the House raises the possibility that Congress could repeal the Affordable Care Act (ACA), also known as Obamacare. But it's still not clear what will replace it.

The American Health Care Act, which was endorsed by President Trump, provides one path forward. But opposition from Democrats and some Republicans in the Senate means it's likely to change before becoming law—if it should pass the Senate, that is.

How it might change matters a great deal. As it stands now, the House plan doesn't bode well for certain sectors of the muni market, particularly nonprofit hospitals, and possibly state general obligation and appropriation bonds.

Of particular concern is a provision that would roll back the ACA's Medicaid expansion and eventually change the way this public insurance program for low-income and disabled people is funded. Instead of contributing a set amount for every dollar that states spend on the program, in 2020 the federal government would under the new plan begin capping payments according to a fixed formula.

Changes in Medicaid along with the scrapping of subsidies and income-based tax credits for buying insurance are big reasons why the Congressional Budget Office, when reviewing a similar early version of the bill in March, estimated that 24 million people could lose coverage under the plan by 2026.

PUTTING HOSPITALS ON THE HOOK

Why should hospitals worry about the number of potentially uninsured patients? It's simple: nonprofit hospitals are required to treat every patient that walks through their doors. When more patients can't pay for lack of insurance, it increases the financial burden on the hospitals.

Having to pick up the tab for more uninsured patients could reduce hospitals' overall revenue at a time when the operating margins for many are already thin. That could put pressure on their bonds, many of which have been issued in recent years with weak legal protections for investors.

A study commissioned last year by both the Federation of American Hospitals and the American Hospital Association estimated that the repeal of Medicaid expansion alone could have net negative impact on hospitals of nearly $166 billion between 2018 and 2026.

Refashioning healthcare—and particularly Medicaid—may also have implications for state finances. Medicaid is already among the largest components of state spending. If healthcare reform includes a cap on what the federal government spends on Medicaid each year, state budgets may take a hit.

A HANDS-ON APPROACH TO YOUR MUNI PORTFOLIO

Because municipal bonds are the bedrock of many investors' overall asset allocation, we believe managers must be able to buffer investor portfolios against the inevitable speed bumps associated with healthcare reform. The only way to do that effectively, in our view, is to embrace an actively managed approach. Investors who can dig deeply into each and every bond are more likely to be able to separate potential winners and losers.

For instance, we think investors should be careful with hospital revenue bonds—particularly those from smaller nonprofits—until we get more clarity about what a new healthcare law may look like. Large hospital systems, on the other hand, tend to have stronger balance sheets and more opportunities for taking advantage of cost efficiencies and are likely to hold up better. For an investor who needs exposure to the sector, the ability to pick and choose is critically important.

When it comes to healthcare reform, the devil for municipal bond investors is in the details. Investors need to be ready for whatever plan eventually becomes law. This isn't the time to put your portfolio on autopilot.

The views expressed herein do not constitute research, investment advice or trade recommendations and do not necessarily represent the views of all AB portfolio-management team.