

The Downturn Analyst™

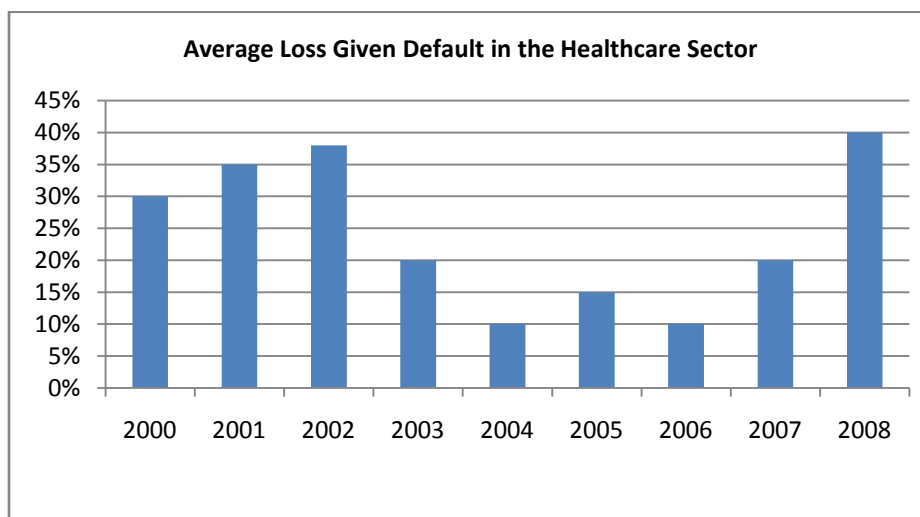
Defaulted Loan Recovery Sector Report Healthcare (May 2009)



Credit to the healthcare sector is traditionally perceived as relatively safe, as demand for healthcare is largely non-discretionary. Nonetheless, dozens of hospitals have gone bankrupt in the last twelve months. This underscores the central question in this series of reports: what is the expected loss for creditors if healthcare providers default?

Based on our databases, the long-run average LGD for senior secured loans in the healthcare sector between 2000 and 2008 is a modest XX%. However, for loans extended to healthcare providers which closed operations and liquidated, the average LGD stood at a much higher level of XX%. The proportion of healthcare providers that fail to work-out or re-organize after defaulting on their loans is clearly increasing in this recession.

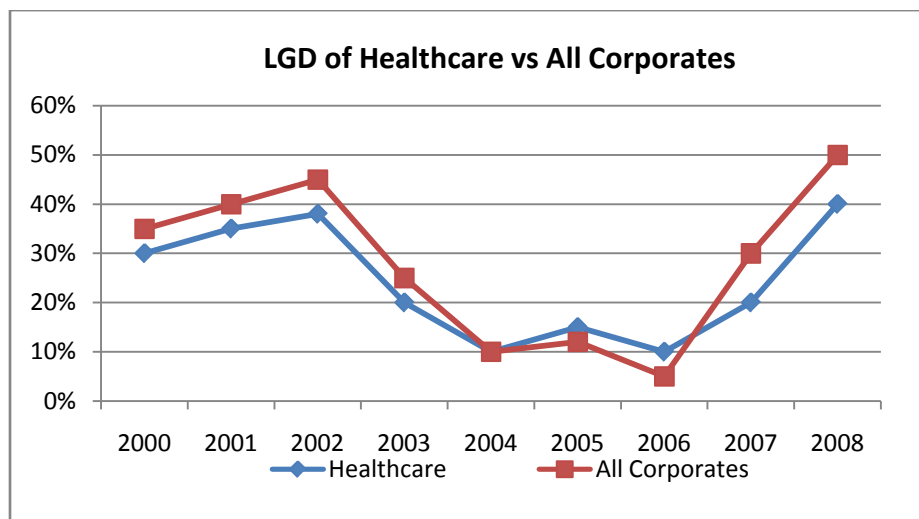
	Average	1 st Quartile	3 rd Quartile	Standard Deviation
Loss Given Default of:				
Senior Secured Loans	XX%	XX%	XX%	XX%
Unsecured Creditors	XX%	XX%	XX%	XX%
Number of Observations: XX Time Period: 2000-2008 Discount Rate Used: 10%				



The Downturn Analyst™

Sensitivity Analysis	5% Discount Rate	10% Discount Rate	15% Discount Rate
Average LGD of:			
Senior Secured Loans	XX%	XX%	XX%
Unsecured Creditors	XX%	XX%	XX%

Because LGD is often very sensitive to the discount rate being used, we offer a variety of discount rates in our LGDs. If you would like us to use a custom discount rate, such as a different rate by year, please contact us.



Collateral Analysis

Collateral Type	Average Loss Given Default	1 st Quartile LGD	3 rd Quartile LGD	Standard Deviation
Real Property	XX%	XX%	XX%	XX%
Accounts Receivable	XX%	XX%	XX%	XX%
Equipment	XX%	XX%	XX%	XX%
All Assets	XX%	XX%	XX%	XX%

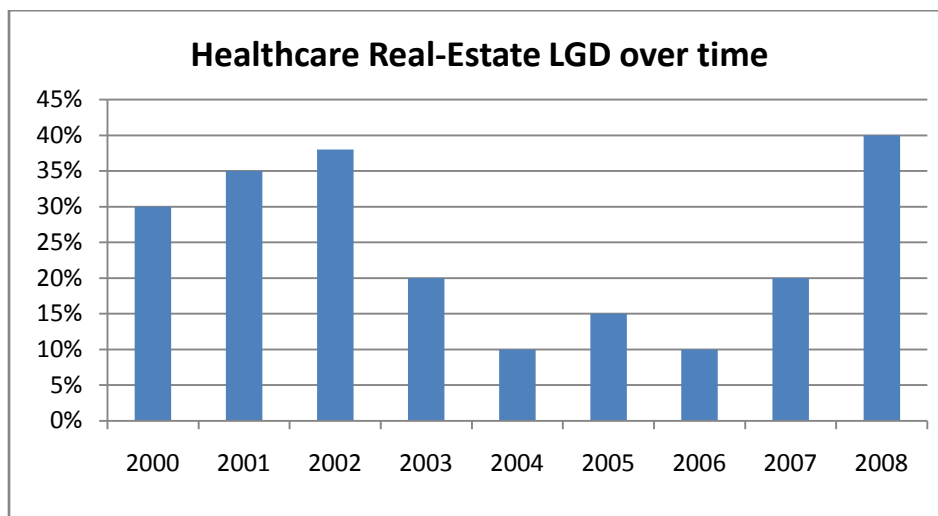
Number of Observations: XX
Time Period: 2000-2008

The Downturn Analyst™

Average LGDs in the healthcare sector are elevated by low recoveries from equipment and inventory collateral. Creditors of Southwest Hospital and Medical Center, a lender secured by a first-priority lien on the debtor hospital's inventory, furniture, fixtures and equipment ended up appraising these as having close to zero value, contributing to an eventual LGD of over 90% or higher.

Real Estate Collateral

The outlook for valuations of real estate collateral backing senior secured loans is worrying, consistent with the outlook on commercial real estate in general. There are cases in our dataset where the liquidation value of the hospital real estate was considerably less than the tax value because, in liquidation, the real property might be sold to a buyer who would not use the facility as a hospital.



The delivery of health care is changing such that an increasing number of patients are receiving their care in ambulatory settings on an outpatient basis. The implication is that older hospitals might have far too many inpatient beds and corresponding fixed costs associated with maintaining these facilities – a key characteristic which makes the hospital building unattractive with reduced market value to potential purchasers in the healthcare sector.

To conclude, while concerns within the US healthcare sector are not as severe compared with cyclical industries, recovery rates within this sector is likely to be stressed by economic conditions and banks should not overlook this sector in terms of re-examining the assumptions underlying their risk ratings and collateral value analyses.

Accounts Receivable, Equipment, and All Assets

Creditors secured by accounts receivable have historically seen high recoveries. Nonetheless, the valuation outlook in some recent liquidation analyses does not seem optimistic. In 2007, Parkway Hospital estimated a loss of around 23-45% on its ARs. St Vincent's Catholic Medical Center estimated the loss to its creditors to be 20% to 40%. In 2008, Victory Memorial Hospital estimated a 60% loss estimate on its receivables in liquidation.

For healthcare providers, a substantial portion of patient care receivables are sourced from governmental third party payors such as Medicare and Medicaid, and non-governmental third party payors including managed care providers and insurance companies (e.g., Aetna, Blue Cross and Blue Shield) – agencies perceived to have low credit risk.

However, there are still risks. For example, Brotman Medical Center experienced a delay in Medi-Cal reimbursements owing to the California legislature's failure to pass a budget in the summer of 2007, contributing directly to its bankruptcy. State budget crises are already leading to significant Medicaid cuts in several key states including California, Florida, Nevada and Georgia. As such, banks may want to closely monitor the receivables aging analysis of healthcare credits in their portfolio.

As for accounts receivable from non-Medicare/Medicaid private pay accounts, these are usually deemed to have low recovery value. With the current economic turmoil and growing pressure on Medicaid reimbursement, healthcare providers will probably see an increase in uninsured patients which would lead to an increase in such accounts receivable and uncompensated care.

Conclusion and Forecast

Declining real-estate valuations and a reduction in available investor capital leading to greater numbers of liquidations will combine to reduce recoveries and increase LGDs in 2009, even in a sector as traditionally safe as Healthcare. However, it is probably safe to say that LGDs will be persistently lower than in commercial and industrial companies in general, so from a relative perspective, given equal probabilities of default, the average bank is probably better off being exposed to healthcare debtors. However, banks must be careful to manage increased probabilities of default in this sector.

This Report was prepared by the owners and authors of thedownturnanalyst.com. By purchasing this report you may use the data and information herein for the commercial purposes of your own institution but may not distribute, re-distribute, re-produce, or sell to others this report or the data and information herein without the written permission of the authors. The authors of this report have made every effort possible to ensure the accuracy of the information herein but make no warranty or representation that every fact in this Report is accurate and are in no way responsible for any errors herein or losses that may result from your use of this report.