Debt Financing for California Community Health Centers and Clinics: *Weighing the Options*

Presented by

Allison Coleman, CEO, Capital Link

Steven Slezak, Project Consultant, Capital Link

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Agenda

- Role of Debt Financing in Capital Projects
- Overview of Debt Funding Sources
- Deciding What's Best for Your Center
- Special Issues: Debt Financing and Capital Campaigns
- Working with Lenders
- Hidden Costs of Borrowing
- Q&A

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Role of Debt Financing in Capital Projects

- Most health center capital projects funded with a combination of "equity" and debt
- Debt extends a clinic's ability to move ahead with a project in the near term and pay for it over its useful life
- Debt is only a feasible option if you can prove to a lender you can pay it back!
- "Sources of Funds" must equal "Uses of Funds"

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Debt Capacity

- Debt Capacity depends on:
- Consistent and/or improving financial performance over time
- Adequate cash flow to support debt
  - Debt Service Coverage Ratio (DSCR) = Change in Net Assets + Depreciation + Interest Expense / Interest Expense + Current Maturities LTD
  - Typical DSCR Requirement = 1.25

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Debt Funding Sources: *Federal Debt & Credit Enhancement*

- USDA
  - Direct loans, loan guarantees, and grant programs
  - Communities of 20,000 population or less eligible
  - USDA provided the following funding to CA rural entities:
    - FFY04:
      - $4.47 million in 4.5% 30-year term loans ($1.3 million to health centers)
      - $25.8 million in loan guarantees ($800,000 to health centers)
    - FFY05:
      - $9.64 million in direct loans ($1.8 million a health center)
      - $157,500 in grants ($62,000 to a health center)

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Debt Funding Sources:
Federal Debt & Credit Enhancement

- HRSA/BPHC Loan Guarantee Program
  - 80% guarantee on loans by non-federal lenders (cannot be used with tax-exempt bonds)
- Empowerment Zone / Enterprise Community funding
  - 39 EZs in CA (see www.caez.org)
  - 3 Rural EZs and 1 rural EC

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Debt Funding Sources: *State-Based Debt & Credit Enhancement*

- Tax-exempt bonds through CHFFA
  - Minimum size ~$5 million for standalone financings;
  - Possibility of pools for multiple borrowers with minimum needs of $500,000
  - Tax-Exempt Equipment Lease Program for equipment financings > $500,000
- Other Issuers
  - For HCs issuing bonds in conjunction with a Healthcare District or municipal authority, possibilities include: GO bonds, COPs, issuances through CA Statewide Communities Development Authority or Association of Bay Area Governments

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Debt Funding Sources: *State-Based Debt & Credit Enhancement*

- Cal-Mortgage Program Credit Enhancement
  - Mainly used in conjunction with tax-exempt bonds
- CHFFA special purpose loan funds
  - Help II Loan Program ($25,000 - $500,000)
    - 3% fixed rates; amortizations up to 15 yrs

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Debt Funding Sources:

Private Sector Debt & Credit Enhancement

- CPCA Loan Program ($200,000 maximum)
- Banks
  - NCB Development Corporation
    - Business Planning Advances, construction and term loans
  - Many large and small commercial banks, S&Ls, FHLBs, etc.

Debt Funding Sources: *Private Sector Debt & Credit Enhancement*

- Community Development Finance Institutions
  - Rural Community Assistance Corp.
    - Mainly in conjunction with USDA guarantees
  - Lenders for Community Development
- Equipment Financing
  - Various banks and leasing companies, e.g. GE Capital

Debt Funding Sources:
New CA Resource!

- Healthy California
  - Collaborative effort of NCB Development Corporation, Impact Community Capital, CPCA Ventures and CCI
  - Utilizes New Markets Tax Credits
  - Creates long-term, low interest, fixed rate financing for CA clinics
  - Began in 2005

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Healthy California: *Overview*

- $20 million pool
- Loan Terms and Conditions:
  - Loan Size: $1.5 - $3 million
  - Interest Rate: 6% fixed (permanent loans); 7% fixed (construction loans)
  - Term & Amortization: up to 25 years
  - Up to 90% Loan-to-Value Ratio
  - Facility must be located in NMTC-eligible areas
  - May require establishment of Special Purpose Entity (SPE) to hold real estate

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Other NMTC Options

- 4th round of tax-credit allocations currently in process
  - NCBDC is applying for additional credits
  - Capital Link is applying for credits
- Awards likely in May 2006; stay tuned for additional financing opportunities using NMTC leverage model

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NMTC Leveraged Transaction

- Combines debt and equity
- Reduces cost to borrower
- Potential for substantial debt forgiveness, "soft second" mortgages or other benefits
- Emerging as primary NMTC structure

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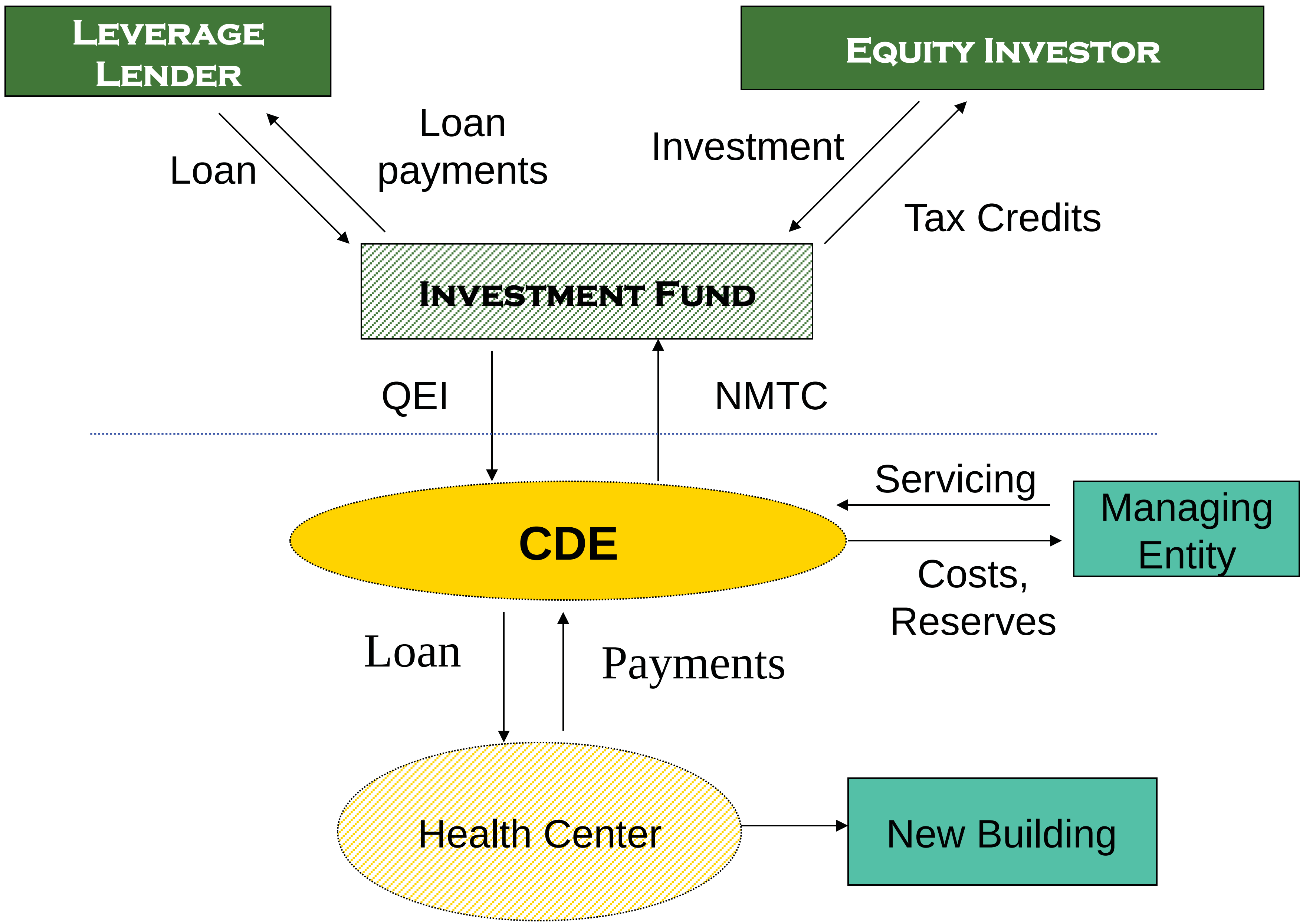

Leverage Lender
Equity Investor
Loan
Loan payments
Investment
Tax Credits
Investment Fund
QEI
NMTC
CDE
Servicing
Managing Entity
Costs, Reserves
Loan
Payments
Health Center
New Building

Deciding What’s Best for Your Center: *Factors to Consider*

- Location/Eligibility
  - Urban or Rural?
  - 330 or not?
  - NMTC or Empowerment Zone-eligible or not?
- Size of Loan
- Interest rate and “all-in” rate
- Credit Strength/Need for Credit Enhancement
  - Spotty financial performance?
  - Much larger loan than clinic could have supported historically?
  - Loan-to-Value issues?
- Relative need for long-term vs. shorter term financing and/or fixed vs. variable
- Interface with capital campaign

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Weighing the Options

	Healthy California	Banks	Tax-Exempt w/ Cal Mortgage	Help II
Loan Size	$1.5 to $3.0 million	up to $5.0 million	$5 - $20+ million	Up to $500,000
Max. Term	25 years	5 to 15 years	30 years	15 years
Max. Amort.	25 years	10 to 20 years	30 years	15 years
Interest Rate	6% fixed life of loan; Const. loans @ 7%	5/10Treasury plus 2.0 to 4.0% w/resets	3 to 5+% fixed	3%
Fees	1.5% plus closing costs	1.0 to 2.0% plus closing costs	3% of total P&I plus 3-5% for closing costs	1.25%
Max. LTV	90%	70 - 75%	90%	95%
Min. DSC	1.1 to 1.0	1.25 to 1.0	1.10–1.25 to 1.0	1.10 to 1.0
Flexibility	Flexible	Somewhat flexible	Rigid	

Special Issues: *Debt Financing and Capital Campaigns*

- Timing is critical!
- Expenses must be matched with cash resources
- Multi-year campaigns can create challenges
  - "Trust me" doesn't work well with banks!
  - May be able to obtain "bridge financing" to cash-flow multi-year campaigns
  - Negotiate "equity in first" provisions
- Watch out for "no call provisions" and/or prepayment penalties (sometimes you can't avoid them!)

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Working with Lenders

- Put your best foot forward
  - A well-crafted business plan goes a long way toward "getting to yes"
- Make the banks compete for your business!
- Negotiate terms and covenants
  - Make sure you understand the covenant requirements
  - Test them against your "worst case" projections
- You don't have a deal until you have a commitment letter
- Read your loan documents and make sure you understand them!

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The Hidden Costs of Borrowing

- Different types of financing have different up-front fees
- You pay for everyone else's attorney!
- Lender's representatives and construction draws
- Hidden costs add up: budget for "soft cost contingency"

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How Can Capital Link Help with Capital Planning and Debt Financing?

- Services Available to CA CCHCs:
  - Covered by CCI (no cost to health center)
    - Work Plan Development
      - Preliminary Financial Feasibility Analysis
        - Financial strengths and weaknesses, debt capacity analysis
      - Customized Work Plan for your project
        - Maps necessary steps to completing a capital project
        - Process, TA resources, Timeline and Budget
        - Provided by Capital Link or Capital Incubator

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How Can Capital Link Help with Capital Planning and Debt Financing?
(continued)

- Provided on a fee basis:
  - Market Assessment
  - Space Planning, Project Budgeting and Project Team Development
  - Lease vs. Buy Analysis
  - Assistance in obtaining federal appropriation grants
  - Financial projections and Business Plan development
  - Loan guarantee and other financing program applications
  - Financing Assistance
    - Analysis of Debt Options
    - Lender RFPs, negotiations and loan closings

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Contacting Capital Link

- In California:

Tony Skapinsky, Project Consultant

Capital Link

979 Osos Street, Suite B3

San Luis Obispo, CA 93401

T: (805) 544-2355

tskapinsky@caplink.org

Steven Slezak will be joining him in Dec 2005

sslezak@caplink.org

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