HUD and USDA Healthcare Facility Financing

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Capital Planning and Debt Capacity Basics

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- What are the clinical and capital needs?
- What can the hospital afford historically and pro forma?
- What restrictions are there to borrowing capacity?
  - ➢ Debt Service Coverage
  - ➢ Loan to value / cost
  - ➢ Debt to Total Capitalization
  - ➢ Statutory limits for District Hospitals
    - Bond Cap – obligation of Taxpayers (Mortgage, Revenue Bond, HUD and USDA do not have to count against the Cap if no G.O. Lien)
    - G.O. limit – 30 years in WA (obligating local taxpayers)

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Capital Planning Basics – Getting Started

- Clinical Model / Financial Capacity / Architect
- Utilize your cost report consultant while considering the future interest and depreciation reimbursement (especially important for CAHs).
- Eventually hospital will need a financial feasibility study.
- Choose appropriate type of financing.
- Financing type should not drive the project.
- Get the project right and financing will be easier to achieve.

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Common Financing Types / Structures

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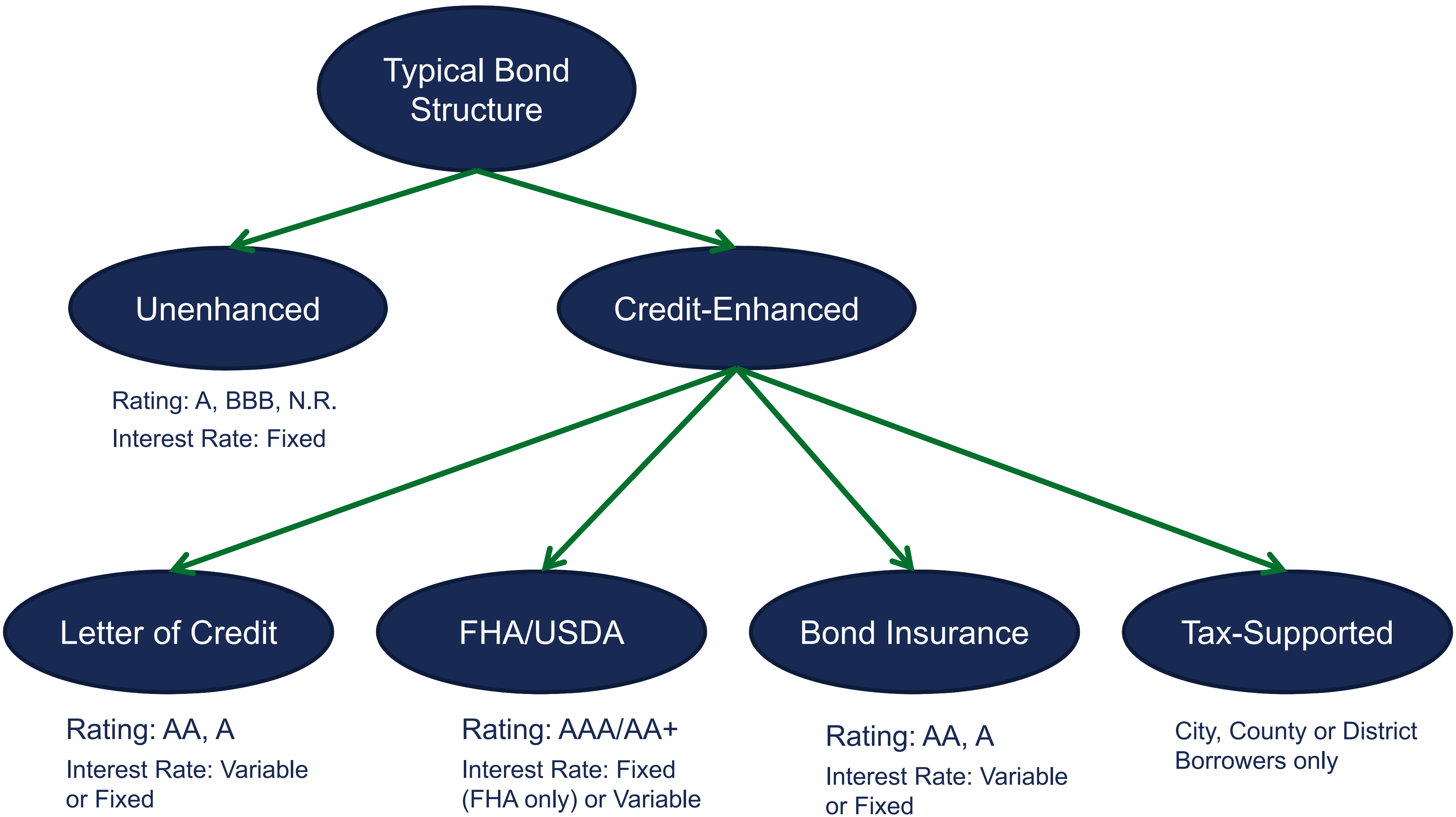
Traditional Debt Structuring Options



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Access to Capital

Local and Regional Resources

Direct bank loans

Direct placement of bonds
- Bank-qualified bonds

Letters of Credit
- Federal Home Loan Bank
- Regional Banks

Government Resources

USDA Programs

FHA-insured HUD mortgages

On Your Own or With Internal Resources

Unenhanced bonds
Tax-backed bonds
Hospital system guarantee

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Unenhanced Revenue Bonds

- Interest rate is based on a borrower's credit profile
- May be rated or unrated
- Term: 25 – 35 years
- In today's market, this option is generally available only to rated borrowers or municipalities

Pros

- No enhancement fees
- Fully amortizing structure
- Fixed rate for life of the loan

Cons

- Prepayment limitations
- Locks in current credit profile
- Debt service reserve fund
- Large interest rate gap between investment-grade and non-IG borrowers

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Tax Supported Bonds

- Tax can be real estate (ad valorem) or sales based
- Interest rate is based primarily on the income and collection of tax receipts
- Analysis focuses primarily on demographics but will also review borrower operations

Pros

- No enhancement fees
- Fully amortizing structure
- Fixed rate for life of the loan
- Ability for non-core operations to pay debt service

Cons

- Prepayment limitations
- Debt service reserve fund
- Sensitive nature of public vote

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- Tax-Exempt bonds structured and privately placed (sold) with banks as opposed to the Letter of Credit enhancement bond structure
- Can be structured as “multi modal”
- Bank-qualified designation can increase bank interest in buying
- Competitive bidding is recommended

Pros

- Limited public disclosure and administrative paperwork
- Flexible terms
- Draw-down construction bonds can reduce costs

Cons

- Must fit with bank’s needs
- Limited long term fixed-rate options
- Difficult for projects >$35M
- Refinance risk (3-10 yr. term)

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Community Facilities Program

- Direct and guaranteed loans, with some limited grants
- Terms up to 40 years
- 90% guaranteed
- Cannot use for 100% refinance
- Fixed or variable rates
- No min/max loan amount
- For populations of < 20,000
- One-time 1% guranty fee
- Loans are taxable

Business & Industry Program

- Guaranteed loans for projects that create or save rural jobs
- $10 million max (up to $25M for special circumstances)
- For areas with populations of <50,000 people
- Fixed rates for up to 30 years
- Up to 80% guarantee
- 3% upfront guarantee fee, plus 0.25% fee annually
- Fixed or variable rates

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- For new construction, renovation, refinance and acquisition
- For borrowers of all sizes
- Program historically concentrated in northeast and is looking for geographical diversification
- Requires a mortgage
- Provides both construction and permanent financing in one loan

Pros

- AAA or AA interest rates
- Annual MIP is fixed
- Special criteria for CAHs
- Long-term amortization
- No renewal risk
- No financial covenants
- Non-recourse to borrower
- Access to supplemental loans

Cons

- Longer lead time to close
- Davis-Bacon union wages for construction (consider modular)

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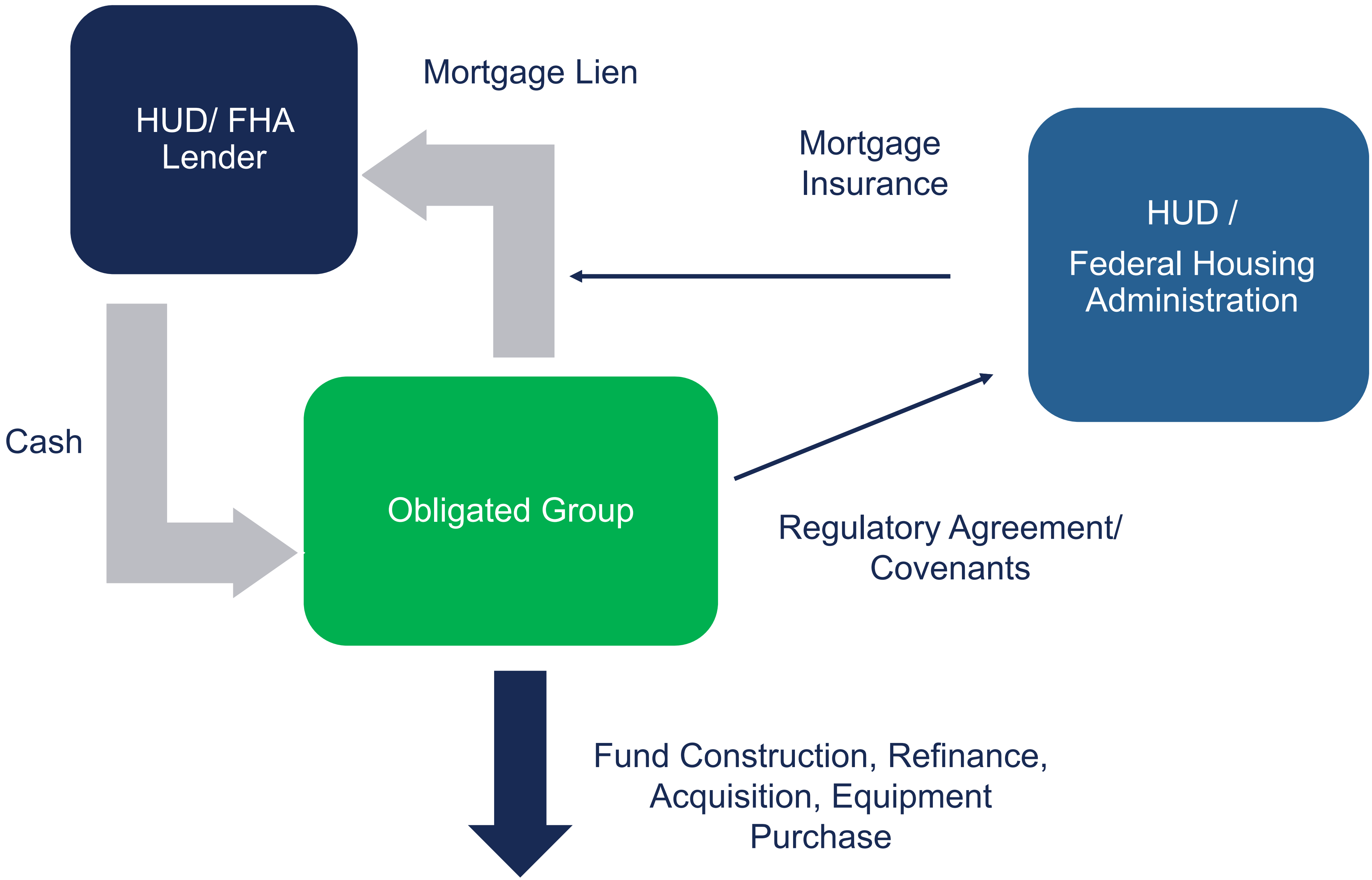
Example HUD / FHA Insured Hospital Mortgage Structure



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Common Types of Hospital Capital Financing - Recap

- There are many types of financing – choose the most appropriate:
  - Revenue Bonds, GO, LTGO, 10-year bank loan
  - HUD / FHA, USDA
- Many considerations including: credit ratings, voter approval, tax support, etc.
- HUD, USDA and Revenue Bonds can provide long-term financing that does not require tax-payer support or voter approval.

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Common Types of Hospital Capital Financing - Recap

HUD and USDA are alternatives to the more common financing types.

- HUD typically requires the least taxpayer involvement.
  - HUD classifies O&M tax revenue as Operating Income for underwriting purposes.
- USDA does not “require” taxpayer involvement, but our observation is that most successful (and timely) applications in the northwest receive significant taxpayer funding.
  - USDA often collateralizes a G.O. Tax Lien and effectively replaces the role of traditional G.O. Bonds.

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HUD and USDA Financing Overview

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If structured as a mortgage or as revenue bond, borrowing has less voter approval requirements but still a low interest rate.

HUD / FHA (Same Thing)

- 100% insured by Federal Gov't
- Requires licensed FHA-lender
- Available anywhere in the United States and territories
- Hospital Loan term of 25-years following construction completion (with up to 12 years of extended term).
- HUD-232 for SNF and ALF loans terms up to 40 years.
- Requires First Mortgage Lien
- RCW 70.44.060 (5) – The "HUD Rule" for Washington District Hospitals

USDA - Direct

- Direct loan from Federal Gov't
- Construction projects require interim financing from private lending source
- Restricted to cities with population under 20,000
- Loan term up to 40 years
  - Districts can take full advantage through Revenue Bond or Mortgage, which are not limited to 30 years.

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HUD Pros and Cons

HUD / FHA (Same Thing)

Pros

- 100% financing (90% LTV)
- Centralized (and streamlined) approval process
- Able to refinance existing capital debt
- No loan size limit / Unlimited capacity
- Credit based decision process
- Permanent “capital partner”
- Able to utilize Taxable funding
- Amortized monthly—less interest over time
- Prefer to finance entire project

HUD / FHA

Cons

- More expensive application fees
- Davis Bacon / Federal Prevailing wage (although, public districts often require this anyway)
    - Consider modular construction

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USDA Direct Pros and Cons

USDA - Direct

Pros

- Too good to be true…if you can get it.
- Low interest rate
- No application fee (to USDA)
- Long-term (40 years, but only 30 years if utilizing G.O Tax Support per WA State statute)
- Able to combine with other funding sources
- Flexible payment schedule
- No federal Prevailing Wage Requirement (but districts are often subject to state Prevailing Wage)
  - Consider modular construction

USDA - Direct

Cons

- Complicated approval chain
- Approval is considered against other projects state-wide and then nationwide.
- Preference for significant (or 100%) local tax support
- Limited refinance opportunity
- Historically prefer to have additional financing sources involved

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HUD and USDA Financing – Attributes of Successful / Timely Applications

Project makes sense:

- Market Demand
- Supported by Financial Feasibility and Market Study
- Historic performance and current trends make the project reasonable / logical
- **Credit Driven**
  - Although the criteria is minimal, the ultimate decision will be grounded in the analysis that the loan will be repaid.
  - With or without tax support, depending on recurring tax contribution revenue
  - Sufficient cash on hand to transition from old facility to new facility
    - Will not necessarily need to contribute the cash into project

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Successful (and <u>Timely</u>) USDA Applications

Community Impact Driven, in addition to Credit Analysis:

- Project must score well (versus other potential projects in the state and country).
- Significant Taxpayer support
  - General Obligation and/or grants
  - Voter Approval
- Letters of support from many local and state leaders
- Economic Impact study
- The entire mosaic needs to fit well together
  - All of the information from the application needs to tie together.
  - The facility plan needs to be supported by the market study.

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HUD and USDA- What Management and Board Can Expect

- HUD Requires Board participation and signed Regulatory Agreement.
- USDA Requires announcement in local paper that Hospital is pursuing USDA.
- USDA requires rejection letters from several other lenders.
- HUD application can be a smooth process if hospital (with or without tax support) performs at a positive margin…as long as project scope is well thought out.

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HUD and USDA- What Management and Board Can Expect

- USDA looks beyond credit/repayment capability and requires significant community support, because this project will take funding resources away from other project applications across the state and country.

- USDA process will be faster as the level of tax support increases relative to project size;

- Both - Address ALL credit weaknesses and other “red flags” upfront!
  - Make the right, first impression.
  - Establish trust through frank discussion / exploration of issues at hand.
    - Revenue Trends and Profitability
    - Management tenure / transition plans
    - Physician recruitment
    - Any bad press!

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Questions

Experience

Based in Vancouver, WA, Nathan leads BMC's Hospital financing team, utilizing programs through the Federal Housing Administration (FHA) and the United States Department of Agriculture (USDA).

Nathan led the Hospital refinancing programs within the Federal Housing Administration (FHA) in Washington, D.C. from 2011-2015, authoring many current credit standards and procedures. At the FHA, Nathan was instrumental in approving 53 hospital construction financing and refinancing transactions in excess of $4.7 billion. Each transaction was unique and many required waivers to the FHA's stated guidelines. Joining the FHA in 2010 to establish the agency's commercial credit risk management office, Nathan was the FHA's first ever Credit Risk Officer.

Education & Community

Harvard University AB in Economics, cum laude;
Columbia Business School MBA;
Washington State Hospital Association affiliate member;
Oregon Healthcare Financial Management Association co-chair.

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Questions?

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