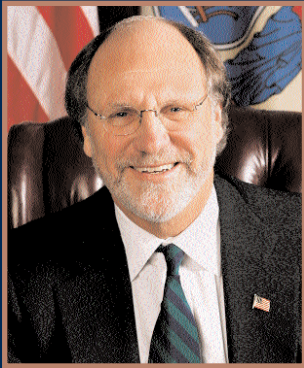


Fall 2006

## FROM GOVERNOR JON S. CORZINE



In my time as Governor of New Jersey there have been many areas that concern me. One such concern is the effective and efficient delivery of health care services to the people of New Jersey, which requires that our hospitals and health care providers be financially secure. Unfortunately, New Jersey's hospitals continue to struggle financially.

While advances in medical techniques and technology add to the quality and length of our lives, these same advances are costly and reduce the length of stay needed by patients in hospitals. As a result, hospitals in certain areas of the state are fiercely competing to attract a shrinking pool of insured patients.

Further, many hospitals, particularly in urban areas, continue to suffer losses from serving an ever-growing population of uninsured patients, despite increased State aid for charity care.

As a result, hospitals in areas where there is a clear need for services are struggling. My administration is working to find a way to ensure the appropriate allocation of limited resources and to ensure that hospital services remain available to all areas in which they are needed.

The Authority joins me and the Department of Health and Senior Services in a mission to create a stronger, more diverse and financially stable health care network in New Jersey. With their help, I look forward to a healthier future, for New Jersey's citizens and hospitals alike. §

## IRS BEGINS NEW TAX-EXEMPT BOND AUDIT INITIATIVE

The Internal Revenue Service announced a new 501(c)(3) bond audit initiative this summer to ensure that borrowers are adhering to the requirements of tax-exempt financing.

The IRS will focus on auditing the bond transactions of twenty or thirty borrowers of proceeds from qualified 501(c)(3) bonds issued between May 1997 and December 1998.

Those borrowers will receive letters from the IRS stating that they have been selected for audit. Two-thirds of the audits are expected to involve hospital bonds.

The audit program will test compliance with the "95/5" rule, which requires that at least 95 percent of proceeds of the bonds (i.e., use of the facility financed with the proceeds of the tax-exempt bonds) be used exclusively for tax-exempt purposes over the term of the issue.

The bonds selected for audit will also be put under a microscope to examine whether a bond-financed facility has had any "unrelated business" use. That is because tax-exempt financings cannot be used to provide facilities that engage in an unrelated trade or business and could generate unrelated business income.

This is in sharp contrast to the treatment usually accorded to hospital facilities that generate unrelated business income. When a hospital finds that it has generated such income, the usual penalty is that it may have to pay some

*(continued on next page)*

## PBI REGIONAL MEDICAL CENTER FILES FOR REORGANIZATION

On July 10th, PBI Regional Medical Center filed for Chapter 11 reorganization. The reorganization allows the facility to receive protection from its creditors, providing it with time to improve its operations, seek potential partners, and ultimately regain its financial footing.



*PBI Regional Medical Center*

PBI Regional Medical Center was created almost three years ago when Atlantic Health System sold its struggling General Hospital Center at Passaic to Passaic Beth Israel Hospital. Passaic Beth Israel Hospital sold its prior facility to the Passaic Board of Education and moved its operations into the larger and more modern facility previously known as the General Hospital Center at Passaic.

To facilitate the consolidation of the two hospitals, the Authority issued \$30.6 million of bonds on behalf of PBI in 2003. In 2004, it issued another \$13.3 million of bonds, which paid down a portion of the 2003 bonds. The 2003 bonds were purchased by Commerce Bank and the 2004 Bonds were part of the Authority's COMP program,

*(continued on page 5)*

## MESSAGE FROM THE EXECUTIVE DIRECTOR

The Authority's role in monitoring borrowers has recently grown more intense. As evidenced by the recent closure of Irvington Hospital, the sale of Mountainside Hospital and the reorganization filing of PBI Regional Medical Center, many New Jersey hospitals are experiencing considerable financial difficulty.

Since 1997, 13 New Jersey hospitals have closed. According to our 2005 year end Apollo report, about 40% of New Jersey hospitals are operating at a loss.

Particularly disturbing is that the difficulties being experienced by New Jersey hospitals are bucking the generally positive national trend.

According to recent reports from the three major rating agencies, nonprofit hospitals nationwide have been performing well over the last several years. For instance, Fitch Ratings noted that in 2005, its "portfolio of nonprofit hospitals and health care systems exhibited significant improvement in profitability exceeding expectations . . ."

The median operating margin for hospitals in Fitch's portfolio was 2.8% and the average days cash on hand was 163.9 days. By comparison, according to the Authority's 2005 Apollo report, the median operating margin for New Jersey hospitals was 0.39% and the median days cash on hand was 75 days.

This continues New Jersey's trend of declining statewide financial medians over nearly two years.

It is difficult to tell whether New Jersey hospitals are going against the national trend due to demographics, management, expenses, funding mechanisms or a combination of the above. Statistics kept by the Authority bear out that volume declines have been an important factor in the financial distress of hospitals. Anecdotal evidence indicates that wage pressures and third party reimbursement changes are contributing factors, as well.

In any event, further research into what has been causing the financial problems for New Jersey's non-profit hospitals is warranted. The Authority stands ready to assist in whatever way it can to help determine the best course of action to keep New Jersey's health care system financially sound. §

## IRS INITIATIVE

(continued from page 1)

unrelated business income tax. But when the facility that has such use has been tax-exempt bond-financed, the entire issue may become taxable if the 5% limit on non-qualifying use of bond proceeds has been exceeded.

A 501(c)(3) entity that uses tax-exempt bonds to finance a facility will have to be certain that no more than 5% of that facility is used for activities that constitute an unrelated business. "There is very little room for error," says Robert S.

Price, consultant for Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C. "Only 5% of the proceeds of the tax-exempt

issue can be used for so-called "bad" purposes, and 2% of that 5% was probably used for issuance costs. So there isn't much leeway." Given the insufficiently detailed regulatory guidance as to what constitutes unrelated business use, the possibility of error is significant.

The examination will focus on: leases of portions of the bond-financed facilities to private businesses (even if health care related), rebate compliance, and management/service contracts or research contracts with private businesses (e.g. physician service contracts, food service contracts, pharmaceutical trials) that fail to satisfy IRS Revenue Procedures 97-13 and 97-14's safe harbor requirements.

Private use or unrelated business use (regardless of whether taxable unrelated income has been generated) uncovered by the audits may cause the bonds to be taxable or, to avoid the bonds losing their tax-exempt status, the borrower may have to pay significant fines and

fees to the IRS.

One question raised in a recent NABL teleconference about the initiative asked how a borrower can prove compliance for a 5-year, 10-year or older bond issue. "The amount of documents to be maintained in some form may be massive, but the IRS has said there may be no other way to confirm compliance," says Howard Eichenbaum, attorney with GluckWalrath LLP. "In addition, under recently issued regulations for refundings, such information will be needed where private use may have to be measured over the combined terms of the refunded and refunding issues."

Borrowers will have to fine-tune their recordkeeping practices to prove compliance, including proper allocation of bond proceeds, and documentation of the use of those facilities from the date of issuance. "I have recently suggested to some borrowers that they find a way to maintain either a copy (possibly through PDF scans) or summary of all potential private use arrangements (e.g., physician contracts, food service contracts, management contracts, etc.) for the life of any new money and refunding tax-exempt bond issues," says Eichenbaum.

The IRS encourages borrowers to self-audit possible tax issues and begin a voluntary correction process to fix any identified problems under the IRS' Tax-Exempt Bond Voluntary Closing Agreement Program ("VCAP"), which allows for more lenient settlements if a hospital uncovers any problems in a bond issue's tax-exempt status before the auditor walks in. Proceeding under the VCAP is no longer an option once an audit begins. §

**The Authority's 2005 Annual Report is now available in hard copy or online at <http://www.state.nj.us/njhcfpa/pdf/05annreport.pdf>**

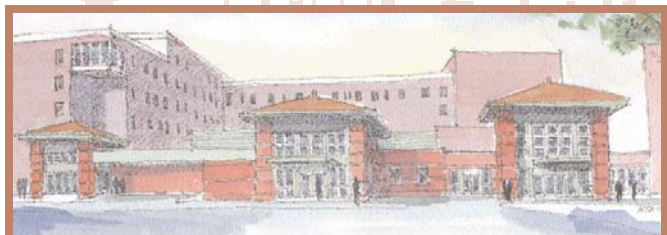
## NJHCFFA 2006 ISSUES

<u>2006 Completed Bond Issues</u>	<u>Issue Structure</u>	<u>Par Amount</u>
Hunterdon Medical Center	Fixed rate	\$22,500,000
Atlantic Health System	PARS rate; reset weekly	\$150,000,000
Southern Ocean County Hospital	Variable rate; reset weekly	\$18,390,000
Virtua Health, Inc.	Private placement	\$35,000,000
Holy Name Hospital	Fixed rate	\$60,000,000
	Debt Issued through 9/1/06:	\$285,890,000

## FINANCING NOTES

On June 15th, the Authority closed a \$60,000,000 bond issue on behalf of **Holy Name Hospital**, a 361-bed acute care center sponsored by the Sisters of St. Joseph of Peace. The proceeds will be used to: update and expand the Emergency Department; currently refund COMP Series 1998 A-4 bonds and COMP Series 2001 A-2 bonds; refinance capitalized leases; and, fund capital equipment.

The fixed rate bonds carried ratings of "BBB" and "Baa2" based solely on the hospital's credit and were structured in a two-term format with sinking funds so that the new bonds' debt service could wrap the the outstanding 1997 issue's debt service to create a level debt service structure.



Rendering of the new ED planned for Holy Name Hospital

The pricing kicked off with an investor call with numerous institutional investors. Holy Name, financial advisor Evergreen Financial Services, and senior manager UBS Securities collectively approved a scale for an order period in which sufficient orders were obtained. UBS offered to purchase the bonds at yields of 4.98% for the 2030 maturity and 5.01% for the final maturity in 2036. The all-in interest cost for the issue is 5.12%.

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On May 23rd, the Authority issued a \$35,000,000 private placement on behalf of **Virtua Health, Inc.** ("Virtua") to finance an information technology digitization system at Virtua's four hospital locations and support sites.

Using a private placement can provide better covenants and easier repayment options, though it does so at a higher cost. The interest rate of this private placement, established by the transaction's term sheet accepted by Virtua, equated to the BMA index plus 50 basis points.

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On May 18th, the Authority closed a \$18,390,000 bond transaction on behalf of Manahawkin's **Southern Ocean County Hospital** ("SOCH"). The financing currently refunded the hospital's 1993 Series A bonds, which, issued on the credit of the hospital, reflect a coupon interest rate between 6.125% and 6.25%. If the projections pan out, assuming a variable interest rate of 3.6% with an extended maturity to 2036, SOCH would reap a net present value savings of approximately \$2.8 million or 13.5% through the refinancing.

Wachovia Bank provided the letter of credit for the variable rate demand notes, which initially reset every 7-days. The bonds were offered for sale just prior to the release of the Bond Market Association index ("BMA") for the week.

Deliberations between Authority staff, SOCH and Wachovia Securities resulted with the issue's order period opening at an interest rate level of 3.4%, with the expectation for BMA to be set at 3.44% to 3.45%.

Sufficient orders were received and the underwriter offered to purchase the bonds at the 3.4% level.

The BMA was actually set at 3.44%, providing the hospital with an initial financial advantage. The rate was reset at 3.44% a week later.

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On May 10th, the Authority closed a \$150,000,000 financing on behalf of **Atlantic Health System** ("AHS"), which operates three divisions referred to as the Morristown, Overlook, and Mountainside facilities.

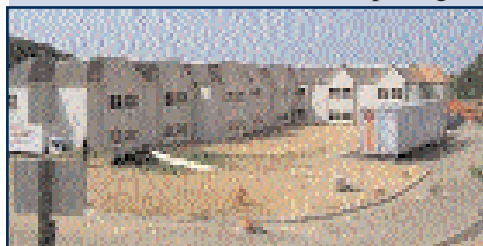
The proceeds of the financing will be used for a major construction project at the Morristown facility and a disaster recovery system at the Overlook facility. The Morristown project, known as the "Heart Hospital," involves the construction of a new five-story facility and three new patient floors on top of an existing structure. Morristown will also be expanding the main lobby of the facility, constructing a "chiller plant" to provide cooling capacity and emergency power,

(continued on page 5)

## ADDICTION TREATMENT CENTER "RECOVERS" FROM WATER SUPPLY DELAY

The Authority-financed **Recovery Management Systems** ("Recovery") addiction treatment facility hit a snag when it was discovered that the facility may need an alternative water and sewer supplier upon the expiration of the current plant.

Recovery, a 260-bed facility, was funded by a \$13.8 million bond issue through the Authority combined with \$6 million from the State Division of Addiction Services. Expected to house one-quarter of New Jersey's gamblers, alcoholics and drug-users who seek treatment, the new facility will play a key role in New Jersey's battle against addiction. Therefore, there was considerable concern when it appeared that an expired water/sewer plant could add significant time and funds to the center's opening.



Construction of the new Recovery facility

Recovery began construction linking into the water and sewer system of its neighbor, the former Marlboro Psychiatric Hospital. According to plans, the State agreed to provide water and sewer from that plant until another suitable source was available, expecting Recovery to immediately pursue alternatives. Since the existing water and sewer system was expected to be sold to the municipality of Marlboro or the Western Monmouth Utilities Authority, Recovery planned to contract with the purchasing utility once the sale had been made.

"We require all approvals to be received before we agree to a financing," said the Authority's Mark Hopkins. "We certainly had reason to believe, that

(continued on page 5)

# NJHCFFA STAFF NOTES



Executive Director Mark Hopkins honoring Michael Ittleson for his 20 years of service

Congratulations to **Stephen M. Fillebrown** and **Michael Ittleson** who each marked their twentieth anniversary with the Authority. Mr. Fillebrown serves as the Authority's Director of Research, Investor Relations & Compliance. Mr. Ittleson is the Authority's Controller.

In addition, Communications Specialist **Stephanie Bilovsky** completed her fifth year of service. The three milestones were recognized by the Authority's staff and Membership.



Steve Fillebrown

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The Authority welcomes **Neetu Thukral** to its esteemed staff. Ms. Thukral joins the Authority's Operations and Finance team as Assistant Account Administrator.



Asst. Account Administrator Neetu Thukral

Prior to joining the Authority in September, Ms. Thukral worked in the General Accounting Department at Geller & Company, and before that, served in various accounting capacities at banking firms such as Skandinaviska Enskilda Banken, Sumitomo Mitsui Banking Corp., Citicorp Investments Services and Reise Organizations, all located in New York, NY. The Authority is pleased to welcome such a qualified candidate to the position.

Congratulations to Human Resources Manager **Robin Piotrowski**, who has been confirmed as a Certified Payroll Specialist by the American Payroll Association. Certification requires certain professional experience and the successful completion of an exam administered by the APA. Ms. Piotrowski is also certified as a Professional in HR by the HR Certification Institute.

Robin Piotrowski, PHR, CPS



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Authority staff members are often asked to share insight through presentations at conferences and seminars. In June, **Jim Van Wart**, Director of Operations and Finance, outlined the Authority's potential construction projects for the coming year at the *Alliance for Action Construction Conference*. Prior to that, Project Manager **Suzanne Walton** presented to *Health Professionals and Allied Employees* about the Authority's funding options to finance equipment for use to transport and lift medical patients.

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**Elizabeth Wood** bid farewell to the new friends she made during her five-month internship with the Authority as an Eagleton Institute of Politics Governor's Executive Fellow. In pursuit of a Masters degree from Rutgers University, Ms. Wood updated APOLLO, researched the relationship between ambulatory care sensitive admissions and hospital financial performance, and researched Federally Qualified Health Care Centers issues. Staff will miss her dedicated work ethic and ever-present smile. §



Elizabeth Wood

# NEW MEMBER NEWS

The Authority consists of four public members and three ex-officio members, namely, the Commissioner of Health and Senior Services, the Commissioner of Banking and Insurance, and the Commissioner of Human Services. Through Governor Jon S. Corzine's nomination of two new cabinet members, the Authority received two new members.



Steven Goldman being sworn in

On March 24, 2006, **Steven M. Goldman** was sworn in as the Commissioner of Banking and Insurance. Prior to his nomination, Mr. Goldman was a senior member and 22-year veteran of Sills Cummis Epstein & Gross PC, where he focused on corporate law, specifically: mergers and acquisitions, banking and finance, joint ventures, and leveraged buy-outs. Mr. Goldman earned a Masters of Law in taxation from New York University ("NYU") School of Law, a Juris Doctorate from the George Washington University School of Law, and an Artium Baccalaureatus in political science from Boston University.

**Clarke Bruno** began serving as Acting Commissioner of Human Services in September. Mr. Bruno's experience includes service as: General Counsel to the NYC Department of Homeless Services; Director of a street outreach program; Special Assistant to a social services agency for the NYC Human Resources Administration; Executive Director of a housing and educational agency in East Harlem; and consultant for Catholic Relief Services in Brazil. Mr. Bruno earned a Bachelor's degree from Swarthmore College, followed by a law degree from NYU School of Law in 1992.

Mr. Bruno and Mr. Goldman will serve as members throughout their terms as Commissioners. §



Clarke Bruno meeting the staff in a DHS walkthrough

## PBI REORGANIZES

*(continued from page 1)*

receiving credit enhancement from a Commerce Bank letter of credit.

The 2003 consolidation was intended to create a more efficient and modern hospital. However, the expected economies of scale failed to result in sufficient financial improvements.

Through this difficult period, the Authority has been monitoring the finances of PBI and attending board meetings. The failure to meet bond covenants triggered a requirement that PBI hire a consultant to make recommendations for improvement.

PBI was also required to adopt the consultant's recommendations and prepare and execute a plan for implementation of the improvements, with periodic reports on progress. Ultimately, after working with several consultants, PBI's board decided to hire a management team from Navigant Consulting.

The Authority worked closely with PBI and Commerce Bank to help them come to some temporary financial arrangement to see PBI through until Navigant's recommendations could prosper. The Department of Health and Senior Services, also closely monitoring PBI's situation, helped PBI make ends meet by advancing its charity care distribution.

Nevertheless, PBI and Commerce failed to reach a financing agreement and time ran out before sufficient financial improvement could be realized. PBI then determined its best course of action was to file for Chapter 11 reorganization.

Absent some temporary financing agreement, on June 19, 2006, Commerce issued a notice of default and accelerated the 2003 bonds. On July 17th, Commerce caused a mandatory purchase of the 2004 bonds, using its letter of credit to purchase the outstanding 2004 bonds from the bondholders. As of June 30, 2006, Authority records show outstanding balances of \$10,567,172 on the 2003 bonds and \$12,175,000 on the 2004 bonds.

Now that PBI is in reorganization it has been negotiating with Commerce and other possible lenders for financing to help it emerge from bankruptcy. It is also actively examining another alternative,

the sale of PBI to, or merger of PBI with, another hospital or hospital system.

Hank Wells, interim chief executive officer who took over the hospital's management with Navigant Consulting on May 24th, has voiced management's commitment to making PBI a viable and financially stable hospital, noting that the reorganization "strategy allows [the] Hospital to continue providing patient care and evaluate future options for Hospital operations." Similarly, PBI's department chiefs and officers of the medical staff reiterated their continued commitment to providing high quality health care at PBI by issuing a supportive open letter to the community, which appeared shortly after PBI's reorganization announcement.

In August, as a cost-cutting measure, PBI laid off 140 hospital employees, including some senior management and part-time employees. PBI also announced it would be temporarily suspending its obstetric, pediatric and out-patient psychiatric services.

The Authority remains hopeful that the current management, utilizing the tools of reorganization, will have success in turning around PBI's finances or possibly partnering with another hospital or system so that PBI can continue to provide quality health care to the people of Passaic and surrounding communities. §

## FINANCING NOTES

*(continued from page 3)*

expanding an existing parking deck, and constructing a new five-story parking garage. This project is expected to add 60 licensed beds to the Morristown hospital.

Overlook's disaster recovery project involves the purchase of hardware and software and any build out accommodating such equipment.

Goldman, Sachs & Co. serves as the underwriter. Insured by AMBAC, the bonds carry "AAA" ratings and are structured in a multi-modal format to give AHS some market flexibility. Initially, the bonds were issued in PARS rate mode, which is the proprietary name for Goldman Sachs's auction rate securities (Periodic Auction Reset Securities). PARS offer a variety of auction period options; the AHS bonds began with weekly auc-

## RECOVERY

*(continued from page 3)*

Recovery had either a permanent agreement with the State or municipal authorization to use their water and sewer."

In the meantime, the NJ Department of Environmental Protection ("DEP") designated vast areas of the hospital property 'environmentally sensitive' halting any plans to sell the existing system to either buyer. Thus, when the plant on the psychiatric hospital site expires, Recovery would have only two options: to build an entirely new water facility to meet the new requirements, or to build access to the closest current supplier approximately one mile away.

These unexpected water and sewer needs would add millions to the project cost and delay the facility opening by two years.

In May, the State assured Recovery and the Authority that it will continue to supply water and sewer to the site but expects Recovery to have a plan for another source by January 2007. Understanding that Recovery will need additional time to accomplish the connections, the State will provide water and sewage from the old site through 2010. With this assurance, the facility will be able to open on schedule.

Both the Department of Treasury and the Western Monmouth Utilities Authority are discussing options for providing water and sewer services after the year 2010.

"We are pleased to see the project move forward, thanks to the combined effort of the State, the local utility and the facility's management, all with the common goal of delivering a much-needed service to New Jersey and its families," says Mark Hopkins. "We hope the involved parties are able to come to an environmentally and financially sound solution in this spirit of teamwork as the project continues." §

tions. Half of the bonds are auctioned on Tuesdays and the other half on Wednesdays to provide AHS with additional flexibility.

After an order period on May 2nd, Goldman Sachs found sufficient interest to purchase the issue at an initial interest rate of just 3.65%. After the first week, the Tuesday rates were lowered to 3.55% and the Wednesday rates to 3.50%. §

# PUBLIC MEMBER CARMEN SAGINARIO JR. RESIGNS

On July 17, 2006, **Carmen Saginario Jr.** submitted to the Authority a letter of resignation from his role as a Public Member. First appointed and then confirmed by the Senate as a Public Member in June of 1998, Mr. Saginario served dutifully in various elected Authority positions including Chairman of the Finance Committee, Treasurer, Secretary, Assistant Treasurer, and Assistant Secretary.

At the Authority's August 26, 2006 Meeting, Mr. Saginario was presented with a framed Certificate of Appreciation, which displayed the Resolution of Appreciation that had been approved on his behalf. He stated that it had been an



*Gus Escher (right) presenting a Certificate of Appreciation to Carmen Saginario Jr. at the August Authority meeting*

honor and a pleasure for him to serve this Authority.

Demonstrating strong knowledge of the

health care system, finance, and law, Mr. Saginario continuously asked questions and made suggestions to ensure that New Jersey's health care delivery systems were effective and the Authority's products and services were best suited to serve the borrowing community.

He also made a point to enjoy his work, never afraid to interject humor or a congratulatory pleasantry. Staff will remember him for his open expressions of gratitude, always remembering to give credit for a job well done.

"It was a pleasure working with Carmen," says Mark Hopkins, Executive Director. "We wish him the best of luck in his ongoing endeavors." §



## SENIOR NJHCFFA STAFF

**Mark E. Hopkins**  
Executive Director

**Dennis P. Hancock**  
Deputy Executive Director,  
Director of Project Management

**Stephen M. Filebrow**  
Director of Research,  
Investor Relations and Compliance

**James L. Van Wart**  
Director of Operations and Finance,  
Custodian of the Public Record

## NJHCFFA MEMBERS

### Ex-Officio Members

**Fred M. Jacobs, M.D., J.D.** Chairman · Commissioner of Health and Senior Services

**Steven M. Goldman** ·  
Commissioner of Banking and Insurance

**Clarke Bruno** ·  
Acting Commissioner of Human Services

### Public Members

**Moshe Cohen, Ph.D.**

**Gustav Edward Escher, III.** ·

*There are currently two Public Member openings at the NJHCFFA.*

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