New Jersey hcffa

AUTHORITY NOTE$

New Jersey Health Care Facilities Financing Authority

April 1995

QUALIFICATION PROCESS COMPLETE...HOSPITALS TO PARTICIPATE

The Authority was the first agency to respond to Governor Whitman's Executive Order No. 26 by adopting a new policy and procedures to be followed in the selection of the method or type of bond sale and the selection of professionals in connection with the sale. As a part of its new process, the Authority approved a list of firms qualified to serve as senior managers, co-managers, financial advisors and private placement agents for bonds issued by the Authority. The list was developed as a result of a formal Request for Qualifications ("RFQ") which was distributed to 100 firms in accordance with the Authority's new policy.

The new procedures provide first for the Authority to determine whether a proposed transaction should be sold on a competitive or negotiated sale basis. After the type of sale has been determined, the Authority will invite three to five firms from its qualified list to make oral presentations to serve as financial advisor or senior managing underwriter, as appropriate. For the first time, the borrowers will be asked if they would like to include any particular firm(s) on the list of firms to be interviewed. In addition, the borrower will be invited to participate in the interviews.

(continued on page 2)

AUTHORITY DEVELOPS NEW LOAN PROVISIONS

The Authority recently announced the adoption of a policy to negotiate new stronger covenants into bond issues for hospitals in the state. The action of the Authority came in response to recent changes in the health care industry, particularly those in New Jersey, which include the elimination of hospital rate regulation and increasing competition in the health care industry.

"The action taken by the Authority seeks to provide a higher level of security for the Authority's bondholders," stated Len Fishman, Commissioner of Health and Chairman of the Authority. "The Authority wanted to arrive at a balance between protecting bondholders and being responsive to business. This new policy will provide an early warning system, to identify hospitals which may be experiencing financial distress, and to initiate specific remedial action."

The Authority adopted its policy following an in-depth study to determine the appropriateness of the existing covenants used in the Authority's bond documents, including a review of programs adopted in other states and discussions with various industry experts.

These experts have indicated that broader indicators and more frequent financial certifications are necessary to provide early warnings of declining financial performance. They generally agree that it takes two to three years to correct a weakening position, and that liquidity is important to be able to make the necessary changes which may be recommended by management consultants.

Given the importance of maintaining a certain level of cash, the Authority adopted a policy to include a cushion ratio covenant, which is a measure of liquidity, in its future hospital financings. This cushion ratio of 1.25 times annual debt service, to be tested on a rolling four-quarter basis, establishes an early warning system for the Authority to detect hospitals that may potentially be in a financially distressed situation. The new policy also establishes remedial measures, including the hiring of an independent consultant to evaluate the seriousness of the situation and to recommend corrective actions. Additionally, the Authority formalized its recent practice of increasing the level of

(continued on page 3)

AUTHORITY NOTE$ has been developed to communicate directly with those who are involved in the financing of New Jersey's health care institutions. It will be published periodically, as needed, to convey changes in Authority policy and practices, tax law and regulations, and to suggest ways to decrease capital expenses and increase revenues. The Authority welcomes your input, ideas and suggestions.

QUALIFICATION *(continued from page 1)*

In addition, the Attorney General has issued guidelines for the competitive selection of bond counsel. At press time, a Request for Proposal has been sent out to law firms which might be interested in serving as bond counsel for the Authority's transactions. It is anticipated that a pool of attorneys will be selected by the Attorney General to serve the Authority for a period of two years.

NEW COOPERATIVE EFFORT BETWEEN AUTHORITIES

The New Jersey Health Care Facilities Financing Authority and the New Jersey Economic Development Authority have developed a new and efficient procedure to determine which of the two agencies is the most appropriate to meet the individual capital needs of health care institutions throughout the state. This new effort was developed in response to the Whitman administration's desire to centralize the issuance and monitoring of health care related bonds at the health care authority. There are some instances, however, where the health care authority's statute may limit the agency's ability to provide for all of an institution's financing needs. This coordinated approach will ensure both efficiency and cost effectiveness.

If you have a project which requires a determination, please write a joint letter to Edie Behr (Executive Director, NJHCFFA, CN 366, Trenton, NJ 08625) and Caren Franzini (Executive Director, NJEDA, CN 990, Trenton NJ 08625) defining the project and the borrower and requesting that a determination be made. To date, the agencies have completed this process for three borrowers and are currently evaluating a request from a fourth.

SECONDARY MARKET DISCLOSURE REQUIREMENTS FOR MUNICIPAL BONDS

In November 1994, the Securities and Exchange Commission ("SEC") adopted new secondary market disclosure requirements which apply to issues sold on or after July 3, 1995. The amended Rule 15c2-12 obligates the underwriter to require that the obligor (borrower) agree in a bond document (loan agreement) to provide certain financial and operational information and to disclose material adverse events over the term of the financing. The underwriter must determine that the disclosure covenant is contained in the financing documents and is prohibited from distributing the securities if such a determination cannot be made.

The new amendment requires the obligor to provide certain financial and operational data to each nationally recognized municipal securities information repository (NRMSIR) and to the appropriate state information depository, if any, on an annual basis. Such financial information and operational data must be of the type which had been included in the final official statement. In addition to providing the aforementioned information and data, the obligor will be required to file a notice with the NRMSIRs upon the occurrence of one of twelve enumerated events including: debt service payment delinquencies; non-payment related defaults; unscheduled draws on debt service reserve funds or credit enhancements; substitution of credit or liquidity providers (or their failure to perform); adverse tax opinions or events affecting the tax-exemption; modifications to rights of security holders; bond calls; defeasances; release, substitution, or sale of property securing repayments of the securities; and rating changes. Notice must also be given in a timely manner of the failure to provide the annual financial/operational information on or before the date specified in the documents.

The National Council of Health Facilities Financing Authorities and the Healthcare Financial Management Association ("HFMA") have jointly developed guidelines to assist health care facilities in the completion of their obligation under the new securities rule. A copy of the guidelines can be obtained from the HFMA by calling (800) 252-4362 extension 420 and requesting Item No. 211133.

GRANTS

The Authority has been exploring alternate sources of funding to assist borrowers. One such program has been designed to help eligible institutions reduce their energy consumption and lower their energy costs. The name of the program is The Institutional Conservation Program ("ICP") which is administered by the New Jersey Board of Public Utilities, Division of Energy Planning and Conservation. The program provides matching grants to eligible institutions for technical assistance analysis (detailed energy audits) and energy conservation measures (actual projects). The maximum grant size is determined annually by the energy office. The Authority could be used as a financing source for the remaining costs. To learn more about the program, call an ICP representative at (201) 648-7419.

Another source for grants is the Robert Wood Johnson Foundation's New Jersey Health Initiatives program. Up to $5 million will be awarded over a three-year period with individual grants totalling between $50,000 and $250,000 each. Grants will be awarded for projects that improve access to primary health care, address the complex service needs of people with chronic health conditions and reduce substance abuse. Additional information can be obtained from Pauline M. Seitz, Director of New Jersey Health Initiatives at (609) 275-4128.

There is also a program available through the Department of Environmental Protection which offers its Community Forestry Challenge Grant to assist organizations in developing unique community forestry projects. The grants are available to counties, municipalities, schools and nonprofit organizations including hospitals. The program's goal is to educate all municipalities in the state about the benefits of developing a project to increase and maintain vegetation (e.g., trees) which will provide more environmental and economic benefit to the communities. One hospital in particular will be applying for the grant to augment landscaping funds as part of its capital expansion plans. For more information, contact Ms. Betsy Saul, Outreach Coordinator, Division of Parks & Forestry at (609) 292-2532.

NEW LOAN PROVISIONS

(continued from page 1)

debt service coverage from 1.10 times maximum annual debt service to 1.25 times maximum annual debt service. This ratio will also be tested on a rolling four-quarter basis.

RATIO DESCRIPTIONS

Debt Service Coverage Ratio

The debt service coverage ratio measures the ability of a borrower to make debt service payments based on the current year's income and cash flow. It is calculated by adding income, depreciation expense, and interest expense from the income statement and dividing this sum by the maximum annual debt service payment due in any one year for all of the borrower's debt. The ratio is expressed in terms of multiples of the annual debt service requirement. For example, a debt service coverage ratio of 1.25 means that income and cash flow for the borrower was one-and-one-quarter times its debt service requirements.

Cushion Ratio

The cushion ratio measures a borrower's ability to make debt service payments from existing cash and liquid reserves. It is calculated by adding cash, board-designated funds, and plant replacement funds and dividing this sum by the maximum annual debt service payment due in any one year for all of the borrower's debt. Like the coverage ratio, the cushion ratio is expressed in multiples of the debt service requirements. For example, a cushion ratio of 1.25 means that the borrower has cash and reserves equal to one-and-one-quarter times its debt service requirements.

The new covenants will be negotiated into documents for new issues of the Authority and will apply only to hospital financings. No change is contemplated for existing issues. This action is intended to ensure continued access to capital at reasonable rates for the hospitals of the state. The Authority also will closely gauge the reaction of the financial markets to the new level of debt service coverage, the cushion ratio and the remedies attached to the covenants, as the Authority completes several projects scheduled for financing in the next six months. Remedies include a requirement to hire an independent consultant and an option for the Authority to communicate directly with Board members of the institution.

Since its creation in 1972, the Authority has issued over $6 billion in tax-exempt revenue bonds and has a perfect record of payment to bondholders.

PROJECT MANAGEMENT OVERSIGHT

In July, 1994, the Authority formally modified its Project Management Oversight Program by delegating the management and operation of the program to Authority staff. The Authority took this action in order to reduce the cost of the program. Jim Van Wart, who has been involved with construction oversight since its inception, is serving as the program administrator. As such, he monitors project costs, schedules and change orders, providing the basis on which to review and approve payment requisitions. The cost to borrowers for project oversight is one-tenth of one percent of construction costs for "bricks and mortar" construction and one-twentieth of one percent of construction costs for prefabricated or precast construction.

PLANT AND EQUIPMENT FUNDS

With the demise of the Chapter 83 system, the Authority approved the release of Plant and Equipment Funds (or the development of an alternative arrangement that may be necessary under certain bond documents). To date, 30 borrowers have received a total of $40 million representing refunded Plant and Equipment Fund monies.

In order to release the funds, a borrower must submit a letter to the Authority indicating an interest in doing so and acknowledging that they will assume responsibility for the associated costs (which include fees for bond counsel and a hospital consultant). For more information, contact June Duggan, Deputy Executive Director at the Authority.

ARBITRAGE REBATES

Borrowers may now net negative arbitrage during any year against positive arbitrage in the calculation of the amount to be rebated. Additionally, refunds of excess arbitrage rebates may be secured from the IRS through the submission of a claim. Borrowers should work with their auditors and arbitrage rebate consultants to assure that they are getting the maximum benefit.

NATIONAL HEALTH CARE RATING TRENDS

According to Standard & Poor's Ratings Roundup..."For all of 1994, ratings were raised on 19 health care issues totaling $1.0 billion of debt, while ratings on 32 issues totaling $900 million were lowered.

"The upgraded facilities reflect successful adaptation to a more restrictive reimbursement environment characterized by decreasing inpatient hospital use rates, rising managed care penetration, and deeper discounting of charges. Successful facilities have branched out through merger, acquisition, affiliation, or internal expansion to create comprehensive geographic networks and service lines able to compete successfully in an increasingly competitive environment. Successful facilities also have found numerous ways to lower per unit costs from layoffs to work redesigning to physician-specific outcomes measures.

"The downgraded facilities are single-site hospitals in competitive markets that have been unable to keep up with the rapid pace of change." *(Reprinted with permission from Standard & Poor's Ratings Group, 1/30/95).*

TAX-EXEMPT ISSUES RELATED TO PHO'S

Health care institutions which are interested in pursuing mergers, affiliations and joint ventures should have their counsel review the documents for any outstanding indebtedness to ascertain whether the contemplated action would impact the provisions of the bond documents. For example, sections of the bond documents entitled "Consolidations and Mergers," "Tax-Exempt Status," "Maintenance of Existence," "Financial Covenants" and "Transfer of Assets" should be closely examined to ensure compliance. In addition, it is recommended that counsel carefully review the proposed action to determine whether it would, in any way, affect or jeopardize the tax-exemption on the bonds or create difficulties under other provisions of the tax code, such as the $150 million limitation on non-hospital 501(c)(3) bonds.

MOODY'S APPROACH TO RATING PHYSICIAN GROUP PRACTICES

Over the past year, Moody's Investors Service ("Moody's") has received a number of inquiries regarding physician group practices. In response to these inquiries, Moody's has outlined credit factors associated with bonds secured by physician group practices and faculty practice plans. The four key credit factors are; (i) organizational structure; (ii) medical staff features (e.g., size and specialty mix); (iii) the group's market presence and its relationship with area hospitals; and (iv) finances, particularly its permanent liquidity.

A number of market forces (growth of managed care, rising healthcare costs and constraints on reimbursement) create new opportunities for physician group practices. These organizations must maintain centralized control as managed care and capitated contracting continue to expand.

A further integration of these organizations into existing healthcare systems is expected and a number of physician groups will take leadership roles in the integrated systems. Hence, a deeper understanding of these organizations and their characteristics will be of greater importance in the credit analysis of the debt they issue. (Source: Moody's Perspective, November 11, 1994)

The Authority may be able to help provide information with respect to financing physician group practices. Please contact Dennis Hancock, Director of Project Management to discuss your financing needs.

For comments, questions or further information, contact:

Edith (Edie) F. Behr
Executive Director
New Jersey Health Care Facilities
Financing Authority
CN 366
Trenton, NJ 08625
(609) 292-8585

New Jersey hcffa