Refinancing Options for MHHEFA Advance Refunding Bonds

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Overview of Advance Refundings

• Publicly offered, tax-exempt bonds generally include a 10-year call option
  – Call option enables borrower to refund the bonds on or after the call date, beginning roughly 10 years from issuance, at par or a small premium (e.g. 101 or 102)
  – Call option is generally exercised to obtain debt service savings or to eliminate restrictive covenants

• If the bonds are not yet callable, the borrower can still refund the bonds through an “advance refunding”
  – Instead of actually retiring the bonds with proceeds of a refunding issue, the borrower issues bonds to fund a defeasance escrow (i.e. the “advance refunding bonds”)
  – Proceeds of the advance refunding bonds are used to purchase securities, the principal and interest of which would be sufficient to pay: (1) debt service on the bonds through their first optional call date, and (2) the full redemption price of the bonds on the call date
Advance Refunding Mechanics

MHHEFA → Advance Refunding Bonds → Investors

Treasury Dealer → Treasury Securities → Trustee/Escrow Agent

P&I on Refunded bonds including redemption price → Refunded Bonds → Defeasance Escrow

Bond Sale Proceeds

Purchase Price of Treasuries

Treasuries
Restrictions on Advance Refunding

- In 1986, Congress passed tax reform legislation ("Tax Reform Act of 1986") that restricted the ability of tax-exempt borrowers, like non-profit hospitals, to issue advance refunding bonds
  - Prior to this legislation, tax-exempt borrowers could issue advance refunding bonds whenever it was economically advantageous to do so
  - Led to multiple series of tax-exempt bonds being outstanding at any one time related to the same project
  - Each series of bonds were Federally subsidized through the tax-exemption, and Congress wanted to limit the tax subsidies as part of the broader tax reform legislation that limited tax shelters

- To limit the tax subsidies, the Tax Reform Act of 1986 limited tax-exempt borrowers to only one advance refunding per financed project
  - Did not limit tax-exempt "current refundings": refunding bonds issued within 90 days of the first optional call date of the refunded bonds or thereafter
Impact of Limits on Advance Refundings

30-Year MMD Since 1995

Source: Bloomberg February 24, 2017
Alternatives to Tax-Exempt Advance Refundings

• Not-for-profit hospitals like Doctors Community Hospital (“DCH”) that are subject to the advance refunding restriction have a number of alternatives:
  – Taxable Advance Refunding – no limitation on issuance because it entails no tax subsidy, but significantly higher interest rates materially impact debt service savings
  – Forward Swap Refunding – exposes hospital to various swap-related risks (e.g. mark-to-market volatility, counterparty risk, basis risk, etc.), but savings can be attractive
  – Tax-exempt Forward Bond Refunding – hospital issues tax-exempt forward delivery bonds but (1) rates include a forward premium that can be significant, and (2) ability to market these bonds is dependent on market conditions, credit rating, forward period, etc.

• We worked with DCH and Capital One on a fourth alternative, a Convertible Placement financing, that had several comparative advantages
  – Unlike a taxable advance refunding, the convertible placement is structured to take advantage of lower tax-exempt rates
  – Does not incorporate an interest rate swap, and the attendant risks
  – Generally lower funding cost than tax-exempt forward delivery bonds
DCH Convertible Placement Refunding Structure

• DCH’s Series 2007A Bonds were only partially advance refundable on a tax-exempt basis due to the limit on multiple advance refundings
  – 5.00% coupon and 7/1/29 final maturity

• DCH issued a taxable note to advance refund the Series 2007A Bonds that couldn’t be advance refunded on a tax-exempt basis
  – Capital One Municipal Funding (“COMF”), an affiliate of Capital One Bank, purchased the note

• Subject to certain conditions being met within 90 days of the first optional call date of the Series 2007A Bonds (7/1/17), COMF agreed to purchase a tax-exempt refunding bond issued by MHHEFA on behalf of DCH
  – The tax-exempt MHHEFA bond, if issued, will refund the taxable note owned by COMF
Convertible Placement Mechanics

On 6/29/16:

- **DCH** | Taxable Advance Refunding Note | **COMF**
  - 3.36%
  - Note Proceeds

- **Treasury Dealer** | Treasury Securities |
  - Purchase Price of Treasuries

- **Refunded 2007A Bonds** | P&I on Refunded bonds including redemption price |
  - Defeasance Escrow

- **Trustee/Escrow Agent**
  - Treasuries
Convertible Placement Mechanics (cont.)

Within 90 days of 7/1/17 (Series 2007A first optional call date):

MHHEFA → Tax-Exempt Current Refunding Bond → COMF

DCH

Tax-exempt Bond Payments @2.18%
Advantages of Convertible Placement Structure

• Convertible placement refunding savings exceed DCH’s minimum savings threshold even if tax-exempt bonds cannot be issued and taxable debt remains outstanding

• Combination taxable/tax-exempt rate creates very attractive funding cost of 2.40% (average coupon)

• Projected net present value savings of $4.62 million, or 11.17% of the refunded bonds

• Minimizes impact of taxable rate, achieves attractive cost of capital relative to other alternatives, and does not expose DCH to swap risks
  – Also faster execution with lower issuance costs than forward delivery bonds
Additional Considerations

• Convertible placement structure entails risk that tax law changes prior to issuance of tax-exempt refunding bond
  – Change in tax law could prevent tax-exempt bond from being issued

• Features that are unique to bank placements, such as make-whole call provisions, increased cost language, covenant requirements, and ancillary business requirements tend to be bank specific and may also apply
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Direct Bank Loan Solution

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March 13, 2017
Direct Bank Loan Solution – Doctors Community Hospital

• Potential Benefits for Bank Loan Refunding Bond
  – The Hospital works directly with the lender/purchaser of the bonds who is positioned to provide flexible and responsive solutions throughout the financing due diligence process. Facts and deal terms can evolve throughout the due diligence and documentation process and it is important to work with a bank partner who can respond accordingly
  – The bank lender can provide a lower cost solution, customized to address specific deal terms and the borrower’s needs

• RFP Process from the Lender’s Perspective
  – In deciding to respond to an RFP, we evaluate a number of factors beyond the financial analysis such as
    • Is there an opportunity for the bank to “distinguish” itself within the proposal – deal terms balanced with a competitive pricing structure?
    • Do we have the opportunity to have an active dialogue, request additional information as needed as part of our review process – Opportunity to meet with the Hospital team was a key factor in submitting a competitive credit structure
    • Do we have prior knowledge/experience with the organization and/or its leadership?
    • What is the time line for the RFP?
Direct Bank Loan Solution – Doctors Community Hospital

• Additional Bank underwriting and due diligence considerations included
  • Financing term and amortization schedule; consideration given to WAM
  • Desire to align public debt provisions with bank credit terms
  • Some areas that created discussion – covenants (including definitions), obligated group structure, reps and warranties
  • Bank’s willingness to find solutions (ex. title insurance, adjustment to financing amounts based on final tax work)

• From the Hospital’s perspective, other factors to consider include
  – Banking team and bank counsel experience with Issuing Authority and deal structure
  – Availability of interest rate options; if fixed rate, what is your ability to enter into rate lock
  – Experience of banking team to support borrowing relationship going forward
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The CFO Perspective

Camille Bash
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What to Expect

1. Convince CEO and Board members to start the process
2. Once you have the best consultants, find the best attorney
   – Understand your corporate structure: exact names and reporting with your attorney
3. Write, write, and then re-write applications to MHHEFA, RFP to potential vendors, review contracts, etc.
4. Complete the Tax Due Diligence Questionnaire with your Attorney for MHHEFA
   – To develop the new Tax Certificate you must understand current bonds and what they refinanced. What part of your facility is being used by for-profits: ATM machines, gift shops, reference lab.
   – Locate all contracts for review by bond counsel following laws
What to Expect

5. Prepare monthly financials for auditors to review
   – Agree on NPV target. When there, just get it done, do not play the what if we wait another day, another week.
   – Decide if you can remove your DSRF.

6. Ensure your EMMA filings are correct based on current bond requirements.

7. Read the prospectus and/or contracts to protect your hospital long after you are retired.

8. Keep the CEO and Board members informed on the progress.

9. Everyone is there to help your hospital get to the finish line
Speaker Biography

- CAMILLE BASH, Chief Financial Officer and Treasurer. Dr. Bash manages all financial and information technology operations of the hospital. Dr. Bash joined Doctors Community Hospital in 2009 as the director of financial services and was promoted to CFO in 2012. She has more than 40 years of experience in finance. Prior to joining Doctors Community Hospital, Dr. Bash was the chief financial officer for Catholic Charities in Washington, D.C., administrator for MedLink Hospital and Nursing Home, chief financial officer at Washington Home and Hospice, and vice president of business operations for Children’s National Medical Center in Washington, D.C. Among her distinctions, Dr. Bash is a certified public accountant and holds a nursing home administrator license in Maryland and the District of Columbia. In addition, she is a fellow with the Healthcare Financial Management Association. Dr. Bash earned her doctorate at Walden University, masters of business administration from the University of Missouri, masters of arts in health care from Webster University in Missouri and a bachelor of business administration from the University of Texas in Austin.
Speaker Biography

• CHARLES (CHUCK) STAFFORD joined the healthcare team at Ziegler in 2011 and is responsible for assisting hospital clients with debt structuring, capital planning, creditor relations, sales, mergers, acquisitions, and joint ventures. Before joining Ziegler, Chuck was a vice president of business development at Quorum Health Resources (QHR), a hospital management, consulting, and turnaround company. Prior to QHR, Chuck was a capital markets specialist at J.P. Morgan Securities in New York, and subsequently led the firm's higher education investment banking efforts in the Southeast. He also previously held capital markets/investment banking positions at General Re Financial Products and Donaldson, Lufkin & Jenrette. Chuck received a B.A. in economics from the University of North Carolina at Chapel Hill, and an M.B.A. in finance from the Wharton School of Business at the University of Pennsylvania.
KATHLEEN MALLOY is Market Manager of Capital One Bank’s Mid-Atlantic Not-For-Profit Banking Group. Backed by the strength of a Top 10 Bank headquartered in McLean, Virginia, the Not-For Profit Banking Group services the specialized needs of nonprofit organizations throughout the Maryland, Virginia and Washington, D.C. region. Kathleen manages a specialized group with 20 years of experience delivering full service commercial banking deposit, lending, treasury management and asset management solutions to tax exempt entities, including nonprofit healthcare organizations. In this role, Kathleen has led her team in delivering customized financing solutions that include tax exempt direct purchase bonds, taxable short term and long term financings as well as new market tax credits solutions. Kathleen has over 25 years of commercial banking experience in the Mid-Atlantic. She has been an active member over the last six years in the Greater Washington Society’s Nonprofit Symposium Planning Committee and maintains memberships in HFMA, the American Society of Association Executives and the Finance and Administration Roundtable. Kathleen holds a Finance Degree from the University of South Carolina.