

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

EXECUTIVE SUMMARY

Applicant: Lucile Salter Packard Children’s Hospital (“LPCH” or “the Hospital”) 725 Welch Road, Palo Alto, CA 94304 Santa Clara County		Amount Requested: \$120,000,000 Requested Loan Term: 30 years Date Requested: May 29, 2003 Resolution Number: F- 298	
Project Sites: 725 and 730 Welch Road, Palo Alto, CA Facility Type: Acute Care Hospital			
Use of Loan Proceeds: Loan proceeds will be used to finance the first phase of a major expansion and renovation project including the purchase of a new clinical information system.			
Type of Issue: Negotiated public offering with fixed rate and auction rate notes (ARNs)		Credit Enhancement: Insurance may be obtained from AMBAC and/or FSA	
Expected Credit Rating: Aaa/AAA (Moody’s/S&P) with insurance or A1/AA- without insurance		Senior Underwriter: Morgan Stanley & Co. Incorporated	
Bond Counsel: Orrick, Herrington & Sutcliffe LLP			
Financial Overview: LPCH is a financially stable organization with strong demand for services and positive operating results. Ongoing support from two Foundations ensures continued successful completion of the Hospital’s goals. LPCH demonstrates the capacity to service additional debt with a strong balance sheet reflecting substantial liquidity and impressive net assets growth.			
Sources of Revenue (000’s): <i>(FYE 08-31-02)</i>			
	<u>Amount</u>	<u>Percent</u>	
Net patient revenue	\$279,249	88%	
Other	26,015	8%	
Net assets released from restrictions	8,156	3%	
Investment income	<u>2,469</u>	<u>1%</u>	
Total support and revenue	<u>\$315,889</u>	<u>100%</u>	
<u>Estimated Sources of Funds (000’s):</u>		<u>Estimated Uses of Funds:</u>	
Par Amount of CHFFA Bonds	\$120,000	Project costs	\$259,787
Fundraising *	89,000	Costs of Issuance	<u>3,213</u>
Borrower Funds	<u>54,000</u>		
Total Sources	<u>\$263,000</u>	Total Uses	<u>\$263,000</u>
<i>* As of March 31, 2003, the total fundraising amount has been received.</i>			
Legal Review: No information was disclosed to question the financial viability or legal integrity of the Applicant.			
Staff Recommendation: Staff recommends the Authority approve a resolution in an amount not to exceed \$120 million for Lucile Salter Packard Children’s Hospital subject to a bond rating of at least an “A” category by a nationally recognized rating agency.			

STAFF SUMMARY AND RECOMMENDATION
Lucile Salter Packard Children’s Hospital (“LPCH” or “the Hospital”)
 May 29, 2003
 Resolution Number: F-298

I. PURPOSE OF FINANCING: LPCH seeks funding for Phase I of its multi-phase facility plan to include expansion of existing space and renovations as well as purchasing a new Clinical Information System.

Construction and renovations\$120,000,000

LPCH is undertaking a substantial master facility project to address current and future capacity requirements related to projected volume growth and major information technology upgrades to its clinical information systems, as well as routine capital expenditures. The master facility project will be done in three phases.

Phase I is designed to maximize the use of existing space for inpatient services within the Hospital’s main facility and will include relocation of outpatient clinics to adjacent leased space. Future phases include a new 90-bed patient pavilion and a new permanent clinic facility. The first phase is not dependent upon completion of subsequent phases.

Renovations to existing space at the main facility hospital (725 Welch Road) include the following:

- Construction of a 6-room operating room suite in shell space on the ground floor.
- Add 16 additional pediatric intensive care beds on the second floor.
- Build-out of 27-bed inpatient cancer center in space vacated by outpatient clinics on the first floor.
- Renovation of existing space to create a third Caesarian Section room in the Labor and Delivery department.
- Enhanced diagnostic imaging capabilities.
- Relocation of outpatient clinics and other services to leased space at 730 Welch Road.

Clinical Information System.....50,000,000

The Clinical Information System project will replace the existing system, which dates back to when the facility opened in 1991. The project involves installation of a clinical documentation system (electronic medical record); and installation of a computerized physician order entry system as well as upgrading and developing interfaces to existing systems in such areas as laboratory and radiology.

Routine Capital Equipment (three years)89,787,000

Phase I is expected to cost approximately \$263 million including financing costs. Proceeds from this financing will partially fund Phase I with remaining capital to be provided from LPCH's operations and philanthropy. The anticipated completion date of Phase I is 2006.

<i>Financing Costs</i>	<u>3,213,000</u>
Partial Bond Insurance (assumes bond insurance for \$45 million fixed rate portion)	1,335,000
Underwriter's Discount.....	878,000
Other costs	1,000,000
<i>Total</i>	<u>\$263,000,000</u>

Financing structure:

- Up to 30-year loan term, fully amortized.
- Negotiated public offering.
- Expected Credit Rating: Aaa/AAA (Moody's/S&P) - if insured, or A1/AA- if not insured.
- Estimated \$45 million Fixed rate and \$75 million Auction Rate Notes
- Sole obligation of Lucile Salter Packard Children's Hospital.*

* See the "Background" section for a further description of this corporate entity as well as other entities that LPCH has been affiliated with.

II. FINANCIAL STATEMENTS AND ANALYSIS:

LUCILE SALTER PACKARD CHILDREN'S HOSPITAL

	<u>Statement of Activities</u>		
	(Unrestricted)		
	(in thousands)		
	Six months ended Feb. 28, 2003	For the Year Ended August 31,	
2003	2002	2001	
(Unaudited)			
Revenues:			
Net patient service revenue	\$ 160,903	\$ 279,249	\$ 240,860
Investment income	1,072	2,469	7,438
Net assets released from restrictions	5,657	8,156	9,035
Other revenue	4,514	26,015	3,785
Total revenues	<u>172,146</u>	<u>315,889</u>	<u>261,118</u>
Expenses:			
Salaries and benefits	78,061	137,010	119,980
Professional fees	2,810	4,125	8,691
Supplies	11,238	23,559	33,615
Provision for doubtful accounts	5,457	18,598	14,989
Purchased services	36,102	62,623	66,096
Depreciation and amortization	5,242	12,872	8,519
Interest	1,266	2,583	2,383
Other	8,288	15,835	(2,877)
Total Expenses	<u>148,464</u>	<u>277,205</u>	<u>251,396</u>
Excess of revenues, gains, and other support over expenses	23,682	38,684	9,722
Change in net unrealized gains, and losses on investments	(2,183)	(5,173)	(1,984)
Donated equipment	-	-	1,116
Net assets released from restrictions used for purchase of property and equipment	992	3,056	5,339
Other	-	79	(3,888)
Increase in unrestricted net assets	<u>22,491</u>	<u>36,646</u>	<u>10,305</u>
UNRESTRICTED NET ASSETS, BEGINNING OF YEAR	<u>176,265</u>	<u>139,619</u> ⁽¹⁾	<u>129,314</u>
UNRESTRICTED NET ASSETS, END OF YEAR	<u>\$ 198,756</u>	<u>\$ 176,265</u>	<u>\$ 139,619</u>

LUCILE SALTER PACKARD CHILDREN'S HOSPITAL

Statement of Financial Position

	(in thousands)		
	<u>As of Feb. 28,</u>	<u>As of August 31,</u>	
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Assets	(Unaudited)		
Cash and Cash Equivalents	\$ 144,317	\$ 104,611	\$ 53,385
Patient accounts receivable, net	46,216	46,938	44,353
Contributions receivable	55,768	31,356	7,157
Inventory, prepaids and other	<u>11,561</u>	<u>4,945</u>	<u>3,064</u>
Total current assets	257,862	187,850	107,959
Investments	114,713	93,862	70,239
Contributions receivable, net	-	18,052	19,447
Property and equipment, net	109,202	114,762	116,947
Other assets	<u>4,092</u>	<u>2,344</u>	<u>4,291</u>
Total Assets	<u><u>\$ 485,869</u></u>	<u><u>\$ 416,870</u></u>	<u><u>\$ 318,883</u></u>
Liabilities and Net Assets			
Current liabilities:			
Current portion of long-term debt	\$ 1,000	\$ 1,000	\$ 900
Accounts payable and accrued liabilities	11,841	20,876	20,114
Accrued salaries and related benefits	16,444	13,179	12,175
Other	<u>31,971</u>	<u>10,542</u>	<u>6,583</u>
Total current liabilities	61,256	45,597	39,772
Other liabilities	15,070	18,246	20,105
Long-term debt, net	<u>37,000</u>	<u>37,000</u>	<u>38,000</u>
Total Liabilities	<u>113,326</u>	<u>100,843</u>	<u>97,877</u>
Net Assets:			
Unrestricted Net Assets	198,756	176,265	139,619
Temporarily Restricted Net Assets	61,547	50,748	23,907
Permanently Restricted Net Assets	<u>112,240</u>	<u>89,014</u>	<u>57,480</u>
Total Net Assets	<u>372,543</u>	<u>316,027</u>	<u>221,006</u>
Total Liabilities and Net Assets	<u><u>\$ 485,869</u></u>	<u><u>\$ 416,870</u></u>	<u><u>\$ 318,883</u></u>

Financial Ratios:

	<u>Proforma (a)</u>		
	<u>FYE Aug. 2002</u>		
Debt Service Coverage (x)	3.87	8.47	3.64
Debt/Unrestricted Net Assets (x)	0.90	0.22	0.35
Margin (%)		12%	1%
Current Ratio (x)		4.12	2.47

(a) Recalculates August 2002 audited results to include the impact of this proposed financing.

Financial Discussion:

LPCH is a financially stable organization with strong demand for services and positive operating results.

In 2000, LPCH's operating performance suffered from costs related to the dissolution of a merger ⁽¹⁾ as well as the lengthy nurses' strike, which occurred during that time. Despite these circumstances, LPCH remained profitable. Since then, operating performance has improved significantly due to better HMO/PPO contracts, improved billings and collections; and an increase in acuity resulting in more patients reaching stop loss thresholds. Consequently, stronger operations as well as increased philanthropy have boosted LPCH's financial position over the last two years. Total revenues have increased 21% from fiscal 2001 to fiscal 2002, while total expenses have only increased 10% over the same period.

Management expects that operations will remain reasonably strong over the next three years, although the California and federal budget situation creates notable challenges. LPCH operates primarily in a managed care environment with the majority of its revenues derived from managed care contracts. In fiscal year 2002, gross patient revenues consisted of 28% Medi-Cal, 59% managed care, and 13% other payers. The impact of possible state and federal budget cuts that could potentially reduce Medi-Cal, DSH (disproportionate share) and CHGME (Children's Hospital Graduate Medical Education) funding poses the main threat to LPCH's future financial performance.

From fiscal year 2001 to fiscal year 2002, LPCH's discharges and patient days increased by approximately 1% and 7%, respectively. A significant portion of the growth is attributed to recruitments and investments in cardiac surgery, which also resulted in an overall increase in patient acuity and average lengths of stay. Volume increases were also experienced in the otolaryngology, hematology/oncology, plastic surgery and neonatology services.

Ongoing support from two Foundations ensures continued successful completion of the Hospital's goals.

In the fall of 2001, the Lucile Packard Foundation for Children's Health announced a major fundraising campaign to support pediatric program development, facility expansion and endowment growth primarily for LPCH and the Stanford School of Medicine. As part of the campaign, the David and Lucile Packard Foundation, a separate foundation from the Lucile Packard Foundation, has provided a \$100 million grant and a commitment to match up to \$200 million in funds to be raised by the Lucile Packard Foundation from the community. As of March 31, 2003, the campaign had raised a total of \$426 million towards the \$500 million campaign goal. LPCH expects a total of \$385 million from the campaign of which \$117 million has been received.

LPCH demonstrates the capacity to service additional debt with a strong balance sheet reflecting substantial liquidity and impressive net assets growth.

LPCH's balance sheet exhibits positive cash flows with strong liquidity. Cash and cash equivalents increased 96% from fiscal 2001 to fiscal 2002 to over \$104 million. The six-month interim results reflect another 38% increase with over \$144 million in cash through February 2003.

⁽¹⁾ See *Background section for further information on merger dissolution.*

LPCH has minimal debt outstanding. Although this proposed financing will increase the Hospital's debt, the pro forma ratio remains at an acceptable level below 1x.

Total net assets increased 43% to over \$316 million in 2002, up from \$221 million in 2001. The interim period is up an additional 18% with almost \$199 million in unrestricted net assets. Debt service coverage is strong at 8.47x in 2002, and pro forma results remain solid at 3.9x. Management anticipates easily meeting all of its additional debt obligations.

III. UTILIZATION STATISTICS:

	Year Ending August 31,	
	<u>2002</u>	<u>2001</u>
Licensed Beds	229	(1) 239
Discharges ⁽²⁾	12,308	12,175
Patient Days	70,271	65,645
Average Length of Stay	5.7	5.4
Average Daily Census	192.5	179.8
Percent Occupancy	81.7%	79.5%
Inpatient Surgical Procedures	2,216	1,873
Outpatient Surgical Procedures	1,215	1,305
Clinic Visits	99,684	97,000

⁽¹⁾Reflects the addition of 6 transitional care nursery beds in April-May and the loss of 16 licensed beds as a result of returning an adolescent unit to SHC in June 2002.

⁽²⁾Excludes well newborns.

IV. ORGANIZATION:

Background: LPCH owns and operates an acute care hospital located in Palo Alto and related facilities located in the San Francisco Bay Area for the care and treatment of sick and injured children. The main facility is a regional, national and international referral center for tertiary and quaternary care. It is the largest single provider of pediatric hospital services in San Mateo and Santa Clara counties. LPCH is nationally prominent in several clinical services, including transplantation, cardiothoracic surgery, and oncology. In addition, LPCH and Stanford Hospital and Clinics (SHC) are the primary affiliates to the Stanford University School of Medicine for providing inpatient and outpatient facilities required for internship and residency programs, clinical research and other programs that aid its academic mission. LPCH also provides obstetric services for expectant mothers, as well as a wide variety of outpatient services through its outpatient clinics and related facilities.

The main facilities of the Hospital are located on the Stanford University (Stanford) campus in Palo Alto on land owned by Stanford and leased to LPCH. LPCH's main facilities are physically connected to SHC's hospital facilities. LPCH also is the licensee for the following three satellite facilities: (i) a nine-bed NICU located in space leased at Washington Hospital in Fremont; (ii) a six-bed NICU located in space leased at Sequoia Hospital in Redwood City; and (iii) a 15-bed adolescent medicine unit located in space leased at El Camino Hospital in Mountain View. In addition, LPCH manages a 14-bed NICU located at Dominican Santa Cruz Hospital.

In 1997, Stanford and The Regents of the University of California agreed to combine the separate health care facilities and services of SHC, LPCH and the University of California, San Francisco Medical Center, into a single clinical enterprise under the control of UCSF Stanford Health Care, organized with Stanford and the University of California as members of the UCSF Stanford Health Care Corporation, and UCSF Stanford Health Care became the sole corporate member of LPCH. In connection with such combination, LPCH became a member of the obligated group originally created by SHC in December 1990.

Two years later, Stanford and the University of California agreed to terminate their relationship. Termination took effect April 1, 2000, with the return of assets and operations to each entity that contributed them, together with liabilities related to those assets. In connection with the termination, SHC replaced UCSF Stanford Health Care as the sole corporate member of LPCH. Effective September 1, 2001, Stanford University replaced SHC as the sole corporate member of LPCH.

Subsequently, SHC and LPCH agreed that LPCH would withdraw from the obligated group created by SHC to enable SHC and LPCH to undertake future financings as separate and distinct credits. LPCH withdrew from such obligated group effective March 11, 2003. LPCH's tax-exempt debt issued in 1993 will be reoffered to amend its 1993 financing documents to provide for substitution of covenants of the Master Indenture LPCH is entering into with Wells Fargo Bank, for the covenants in the SHC master indenture.

Currently, there are certain operational relationships among Stanford's School of Medicine, SHC and LPCH. LPCH and SHC have contiguous facilities on the University's campus in Palo Alto and are related through its common parent, the University. LPCH and SHC share certain services, including information systems, human resources, managed care contracting and materials management. In addition, LPCH leases its workforce from SHC. The costs for shared services are allocated between SHC and LPCH, with the latter's cost reflected in purchased services on its statement of operations and changes in net assets.

Licenses: LPCH is licensed by the State Department of Health Services to operate as a General Acute Care Hospital. It received its most recent three-year accreditation from the Joint Commission of Accreditation of Healthcare Organizations in July 2001.

Competition: LPCH competes with local community providers for general obstetrics and pediatrics care and competes on a regional, national, and international basis for unique tertiary services such as pediatric cardiovascular surgery and kidney and liver transplantation. There are eight stand-alone children's hospitals in California. However, LPCH is the only freestanding pediatric inpatient facility in the San Francisco Bay Area affiliated with and located on the campus of a major academic teaching institution due to its close ties to the Stanford University School of Medicine.

V. SECTION 15438.5 OF THE ACT (Savings Pass Through):

It is the intent of the Legislature in enacting this part to provide financing only to health facilities that can demonstrate the financial feasibility of their projects. It is further the intent of the Legislature that all or part of any savings experienced by a participating health institution, as a result of that tax-exempt revenue bond funding, be passed on to the consuming public through lower charges or containment of the rate of increase in hospital rates.

LPCH has provided a description of its savings pass through in Attachment A.

VI. SECTION 15459.1 OF THE ACT (Community Service Requirement):

As a condition of the issuance of revenue bonds, whether by the Authority or any local agency, each borrower shall give reasonable assurance to the Authority that the services of the health facility will be made available to all persons residing or employed in the area served by the facility. As part of this assurance, borrowers shall agree to a number of actions, including (a) To advise each person seeking services at the borrower's facility as to the person's potential eligibility for Medi-Cal and Medicare benefits or benefits from other governmental third-party payers, (b) To make available to the authority and to any interested person a list of physicians with staff privileges at the borrower's facility, and (c) To post notices in appropriate areas within the facility regarding services being available to all in the service area. This agreement is a standard "Certification and Agreement Regarding Community Service Obligation".

LPCH has executed this certificate, included as Attachment B and submitted its current list of physicians, specialties, languages spoken, telephone numbers and whether Medi-Cal and Medicare patients are accepted.

VII. COMPLIANCE WITH SEISMIC REGULATIONS:

SB 1953 (Chapter 740, 1994) requires that all acute care hospitals in California meet specific seismic safety standards by 2008 and 2030.

LPCH has provided a description of its seismic requirements. See Attachment C.

VIII. OUTSTANDING DEBT:

<u>Description</u>	<u>Original Amount</u>	<u>Amount Outstanding As of 08/31/02 (a)</u>	<u>Estimated Amount Outstanding After Proposed Financing</u>
Existing:			
Variable Rate COPs, 1993	\$41,400,000	\$38,000,000	\$38,000,000
Proposed:			
CHFFA, Bonds 2003 – Series A,B, and C		<u>N/A</u>	<u>120,000,000</u>
TOTAL DEBT		<u>\$38,000,000</u>	<u>\$158,000,000</u>

(a) Includes current portion

IX. LEGAL REVIEW:

Staff has reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. No information was disclosed to question the financial viability or legal integrity of this applicant.

X. STAFF RECOMMENDATION:

Staff recommends the Authority approve a resolution in an amount not to exceed \$120 million for Lucile Salter Packard Children's Hospital subject to a bond rating of at least an "A" category rating by a nationally recognized rating agency.