CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

VALLEY PRESBYTERIAN HOSPITAL ("VPH")
Series 1997

Resolution 2005-20

December 1, 2005

Second Amendment to Loan Agreement

ISSUE: In Fiscal Year 2004, VPH was again unable to meet its Net Income Available for Debt Service requirements as amended by the First Amendment to the Loan Agreement (the "2004 Amendment"), adopted by the Board on August 26, 2004. In consideration of a waiver of this requirement and other defaults by MBIA Insurance Corporation ("MBIA"), VPH has agreed to further amend the 1997 Loan Agreement. The proposed Second Amendment to the Loan Agreement (the "2005 Amendment") continues the same income available for debt service requirement as provided by the 2004 Amendment, but requires VPH to compute and certify the Net Income Available for Debt Service amount within 90 days of the end of the fiscal year rather than 150 days as provided under the 1997 Loan Agreement. The 2005 Amendment also modifies the test that VPH must meet in order to incur Long-Term Indebtedness, making it more restrictive. Additionally, the 2005 Amendment places more restrictions on the ability of VPH to sell its real property, improvements or fixtures. Finally, the 2005 Amendment requires that VPH furnish financial statements within 90 days of the end of the fiscal year rather than the previously required 150 days and that VPH appoint a Chief Reorganization Officer.

BACKGROUND: The Authority issued its California Health Facilities Financing Authority Insured Hospital Refunding Revenue Bonds (Valley Presbyterian Hospital), Series 1997 (the "Bonds") in the original aggregate amount of $55,155,000. The amount outstanding as of September 30, 2005 is $30,615,000. The Bonds were issued pursuant to an Indenture between the Authority and First Trust of California, N.A., succeeded by U.S. Bank N.A., (the "Trustee"), and are insured by MBIA (rated AAA by S&P). All payments of principal and interest to date have been fully and timely made.

In Fiscal Year 2003, VPH failed to meet its Net Income Available for Debt Service. In 2004, as part of MBIA's waiver of this default, the 1997 Loan Agreement was amended to reduce the number of encumbrances that VPH is permitted to incur with respect to the Gross Revenue Fund and to clarify MBIA's rights with respect to the ability to exert greater control over the Gross Revenue Fund. Additionally, the 2004 Amendment modified the provisions of the 1997 Loan Agreement with respect to the applicable debt service coverage ratio and required VPH to provide further security for the loan repayments. This resulted in clarifying that if Net Income Available for Debt Service ratio is below 1.0x, an event of default will be deemed to have occurred. VPH also was required to execute a Deed of Trust to secure loan repayments. Lastly, the 2004 Amendment restricted the ability of VPH to lease out its property.

In November 2003, VPH employed the Camden Group, a management consulting firm, to improve its operating performance. The Camden Group completed its management consulting in spring of 2004 and VPH implemented the consultant's recommendations. VPH did not get the results it expected from these recommendations. Subsequently, MBIA hired a consultant that recommended VPH develop its business and physician relationships to improve its performance. VPH is in the process of implementing these recommendations and has focused mainly on the Emergency Room and Labor and Delivery to recruit physicians and nurses to reduce contracting service expenses and to build strong community support. VPH's management anticipates that these changes will have a positive effect on its operations.

MBIA indicated that it would consent to another waiver of these events of default contingent upon the additional covenants included in the Second Amendment to the Loan Agreement.

Key provisions of the 2005 Amendment include:

- VPH certifies to compute the Net Income Available for Debt Service amount within 90 days after the end of the Fiscal Year rather than 150 days.

- Modifies the test that VPH must meet in order to incur Long-Term Indebtedness, making it more restrictive.

- Additional restrictions on the ability of VPH to sell its real property, improvements or fixtures.

- VPH to provide audited financial statements within 90 days rather than 150 days and appoint a Chief Reorganization Officer.

LEGAL REVIEW: Staff has reviewed VPH's responses to the Legal Status Questionnaire. No information was disclosed to question the financial viability or legal integrity of VPH.

STAFF RECOMMENDATION: Staff recommends the Authority approve a resolution authorizing the Second Amendment to the Loan Agreement for the Authority's Valley Presbyterian Hospital, Series 1997 Bonds.