

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

The HELP II Program

EXECUTIVE SUMMARY

Applicant: Mental Health Systems, Inc. ("Mental Health") **Amount Requested:** \$487,917
9465 Farnham Street **Requested Loan Term:** 15 years
San Diego, CA 92123 **Date Requested:** July 26, 2007
San Diego County **Resolution Number:** HII-200

Project Site: 474 West Vermont Street, Escondido, California, San Diego County
Facility Type: Outpatient Alcohol and/or other Drug Services

Background: Mental Health has provided mental health, drug and alcohol rehabilitation services for nearly 30 years, and currently serves over 31,000 clients per year. The mission of Mental Health is to improve lives and instill hope by using new and creative treatment strategies while respecting time proven methods of intervention. Mental Health administers programs for charitable purposes in connection with the community and individual mental health, substance abuse and vocational rehabilitation programs.

Use of Loan Proceeds: HELP II Loan proceeds will be used to refund the 1994 STARTS Series B bonds, the implementation of which has historically imposed on the borrower an ongoing shortfall in the debt service reserve fund. This financing also has the beneficial effect of reducing the borrower's debt service payments providing an annual debt service savings of approximately \$36,000.

Type of Issue: HELP II Loan
Prior HELP II Borrower: No
Payments up to date: N/A

Financial Overview: Mental Health's revenue is highly dependent on government contracts. The balance sheet has fluctuated with large swings in cash and cash equivalents, however, Mental Health has the ability to manage the loan obligation.

<u>Estimated Sources of Funds:</u>		<u>Estimated Uses of Funds:</u>	
HELP II Loan	\$487,917	Refund STARTS	\$487,917
Borrower's Funds	<u>8,100</u>	Financing Cost	<u>8,100</u>
Total Sources	<u>\$496,017</u>	Total Uses	<u>\$496,017</u>

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 for a HELP II Loan for Mental Health Systems, Inc. in an amount not to exceed \$487,917 for a term of 15 years and financing terms acceptable to the Authority.

STAFF SUMMARY

**Mental Health Systems, Inc.
("Mental Health")**

July 26, 2007

Resolution Number: HII-200

I. PURPOSE OF FINANCING: HELP II Loan proceeds will be used to refund the 1994 STARTS Series B bonds, the implementation of which has historically imposed on the borrower an ongoing shortfall in the debt service reserve fund. This financing also has the beneficial effect of reducing the borrower's debt service payments providing an annual debt service savings of approximately \$36,000.

***Refund Authority 1994 STARTS Series B Bonds* \$487,917**

Mental Health seeks to refund the 1994 STARTS Series B Bonds that were previously used to purchase the facility on West Vermont Street in Escondido, California to provide outpatient alcohol and substance abuse treatment to low-income residents and indigent members of the community. Management estimates the current value of the property to be \$800,000, leading to a loan to value ratio of 61%.

***Financing Costs* 8,100**

Authority Closing Fee \$6,100

Title/Escrow/OtherFees 2,000

***Total* \$496,017**

Financing Structure and Terms:

- 15-year fully amortized loan term in the amount of \$487,917.
- 180 equal monthly payments of approximately \$3,370 (total annual payments of \$40,440).
- Total interest payments of approximately \$118,587.
- A first position lien on property located 474 West Vermont Street, Escondido, California.
- A first position lien on corporate gross revenue pledge.

II. FINANCIAL STATEMENTS AND ANALYSIS:

Mental Health Systems, Inc. Statement of Activities (Unrestricted)

	Fiscal Year Ended June 30,		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
<u>REVENUE AND SUPPORT</u>			
Contract revenue	\$ 65,885,020	\$ 61,821,513	\$ 52,037,857
Purchased services	-	-	2,281,419
Other revenue	2,113,545	2,096,977	4,561,634
Insurance revenue	2,496,244	3,498,674	5,090,235
Client fees	-	-	498,208
Donations	406,380	-	-
Net released from restriction	68,780	455,975	247,174
Total revenue and support	<u>70,969,969</u>	<u>67,873,139</u>	<u>64,716,527</u>
<u>EXPENSES</u>			
Payroll	28,090,629	25,656,475	24,585,633
Purchased services	17,373,947	19,523,392	18,828,625
Payroll benefits	5,759,230	5,656,543	5,446,491
Occupancy costs	4,305,074	4,338,220	3,491,333
Consultants	2,763,030	1,312,705	1,835,263
Accounting and legal	104,656	60,885	127,707
Depreciation	346,699	283,338	292,224
Dues and subscription	46,682	42,190	49,833
Equipment rental	270,023	261,738	223,974
Housekeeping and general supplies	185,671	126,995	119,240
Insurance	2,192,326	2,017,982	1,442,830
Interest and bank fees	342,318	277,211	358,547
Laboratory fees	1,680,903	600,939	732,052
Licenses and taxes	40,539	32,644	35,151
Minor/major equipment	499,750	495,475	912,495
Office supplies	797,193	811,427	806,214
Other business services	1,101,325	725,232	655,744
Printing and advertising	313,216	210,482	288,325
Repairs and maintenance	191,431	222,164	183,663
RT / OT supplies and food	558,265	841,052	666,116
Staff development	236,342	879,607	645,098
Travel and transportation	1,067,852	938,480	751,651
Utilities and telephone	1,256,908	1,397,740	1,237,101
Bad debt	369,766	48,947	33,038
Unallowable costs	271,578	234,372	36,188
Total expenses	<u>70,165,353</u>	<u>66,996,235</u>	<u>63,784,536</u>
<i>Change in unrestricted net assets</i>	<i>804,616</i>	<i>876,904</i>	<i>931,991</i>
Unrestricted net assets, beginning of year	<u>6,337,108</u>	<u>5,460,204</u>	<u>4,528,213</u>
Unrestricted net assets, end of year	<u>\$ 7,141,724</u>	<u>\$ 6,337,108</u>	<u>\$ 5,460,204</u>

Mental Health Systems, Inc.
Balance Sheet

	As of June 30,		
	2006	2005	2004
<u>ASSETS</u>			
Current assets:			
Cash and cash equivalents	\$ 1,301,818	\$ (73,459)	\$ 3,076,782
Investments	458,904	395,441	612,516
Contracts receivable	11,322,615	15,282,985	9,030,548
Accounts receivable	-	458,588	114,796
Other receivables	888,699	-	-
Prepaid expenses	336,070	253,463	277,272
Total current assets	14,308,106	16,317,018	13,111,914
Property and equipment, net	3,972,117	4,206,417	4,026,727
Other assets	1,583,052	982,356	634,981
Total assets	\$19,863,275	\$ 21,505,791	\$ 17,773,622
<u>LIABILITIES AND NET ASSETS</u>			
Current liabilities:			
Accounts payable and other liabilities	\$ 4,104,986	\$ 3,951,747	\$ 3,640,615
Accrued employee benefits	4,055,328	3,761,096	3,119,424
Accrued payroll and related taxes	582,008	1,373,161	1,181,203
Deferred compensation payable	432,234	358,314	579,180
Unearned contract revenue	443,202	324,222	345,178
Notes payable, current portion	134,493	2,225,569	226,225
Other accrued expenses	84,143	55,967	9,289
Total current liabilities	9,836,394	12,050,076	9,101,114
Notes payable, net of current portion	2,726,891	2,891,560	2,930,583
Total liabilities	12,563,285	14,941,636	12,031,697
Net assets:			
Unrestricted	7,141,723	6,337,108	5,460,204
Temporarily restricted	-	227,047	281,721
Restricted	158,267	-	-
Total net assets	7,299,990	6,564,155	5,741,925
Total liabilities and net assets	\$19,863,275	\$ 21,505,791	\$ 17,773,622

Financial Ratios:

	<u>Proforma (a)</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Debt Service Coverage (x)	2.96	3.13	0.57	2.71
Debt/Unrestricted Net Assets (x)	0.47	0.40	.048	0.94
Margin (%)		1.04	0.62	1.05
Current Ratio (x)		1.45	1.34	1.41

(a) Recalculates 2006 audited results to include the impact of this proposed financing.

Financial Discussion:

Mental Health's revenue is highly dependent on government contracts.

During our review period, Mental Health's primary funding source has been government contract revenues, which accounts for approximately 93% of total revenues. Other revenue sources include insurance revenue, donations and other miscellaneous revenue. Mental Health continues to keep total expenses in line with revenues, increasing from \$63.7 million in fiscal year 2004 to \$70.1 million in fiscal year 2006, an increase of 10%.

Mental Health added over 30 programs between fiscal year 2004 and fiscal year 2006. These programs include the Family Recovery Center, the Fontana Regional Recovery Center, the Santa Barbara Center For Change, the Desert Star Substance Abuse Center and the Breaking Cycles. Mental Health has experienced a strong demand for its services exhibited by client visits, which have increased from approximately 829,000 visits in fiscal year 2004 to over one million visits in fiscal year 2006, an increase of 30%.

The balance sheet has fluctuated with large swings in cash and cash equivalents, however, Mental Health has the ability to manage the loan obligation.

Mental Health's current balance sheet has fluctuated over the review period. Cash and cash equivalents ranged from \$3.0 million to a negative \$73K and \$1.3 million in fiscal years 2004, 2005, and 2006 respectively. The large swings were primarily due to accounts receivable timing issues. Net property and equipment decreased from \$4.0 million in fiscal year 2004 to \$3.9 million in fiscal year 2006 due to prudent spending on owned assets. The proforma debt service ratio of 2.96x indicates that Mental Health can likely manage the proposed debt.

III. UTILIZATION STATISTICS:

Mental Health Systems, Inc.
Clients Served / (Client Visits)

	<u>Fiscal Year Ended June 30,</u>		
	<u>2006</u>	<u>2005</u>	<u>2004</u>
Totals	31,542 / (1,087,500)	29,782 / (979,600)	25,211 / (829,257)

IV. ORGANIZATION:

Background:

Mental Health Systems, Inc. was organized June 2, 1978 and was founded to provide mental health, drug and alcohol rehabilitation services in an innovative and cost effective manner primarily by means of government contract. The mission of Mental Health is to improve lives and instill hope by using new and creative treatment strategies while respecting time proven methods of intervention.

In addition, Mental Health provides administrative services as one of California's Substance Abuse System Coordinating Agencies. Mental Health administers programs for charitable purposes in connection with the community and individual mental health, substance abuse and vocational rehabilitation programs.

Licenses:

Mental Health is licensed as an Outpatient Alcohol and/or other Drug Services with the Department of Alcohol and Drug Programs.

V. OUTSTANDING DEBT:

<u>Description</u>	<u>Original Amount</u>	<u>Amount Outstanding As of 6/30/06*</u>	<u>Estimated Amount Outstanding After Proposed Financing</u>
Existing:			
CHFFA STARTS, Series 1994B	\$617,307	\$487,917	\$-0-
California Dept. of Housing, 1991	162,500	229,185	229,185
NCB Development, 1992	2,025,000	1,845,421	1,845,421
Evergreen Servicing, 2004	135,000	11,971	11,971
City of Oceanside Dept. of Housing, 2004		144,171	144,171
Proposed:			
HELP II Loan CHFFA, 2007			487,917
TOTAL DEBT		<u>\$2,718,665</u>	<u>\$2,718,665</u>

*Does not include current portion.

VI. DUE DILIGENCE:

Due diligence has been completed with regard to the following items:

- Section 15438.5 of the Act (Savings Pass Through): Mental Health provided a description of its savings pass through in Exhibit A.
- Section 15459.1 of the Act (Community Service Requirement): Mental Health executed this certification indicating that Medi-Cal and Medicare patients are accepted. A copy of the certification is provided as Exhibit B.
- Religious Due Diligence.
- Legal Review.

VII. STAFF RECOMMENDATION:

Staff recommends the Authority approve a resolution for a HELP II Loan for Mental Health Systems, Inc. in an amount not to exceed \$487,917 for a term of 15 years and financing terms acceptable to the Authority.