CALIFORNIA EDUCATIONAL FACILITIES AUTHORITY

HEALD COLLEGE (“Heald”)
Private Placement Revenue Bonds, Series 2003
Resolution No. 2006-05
July 27, 2006

First Amendment to the Financing Agreement

ISSUE: Two technical events of default have occurred in a bond issued by the Authority on behalf of Heald. Wells Fargo Bank, the sole bondholder, has waived noncompliance and is requesting certain amendments be made to the Financing Agreement that add a new provision and modify existing covenants. The provisions of these amendments are listed in Exhibit A.

Current events of default:

- Consolidated adjusted earnings before interest, taxes, depreciation and amortization (“EBITDA”) coverage ratio - The existing Financing Agreement states that Heald shall not permit the Consolidated Adjusted EBITDA Coverage Ratio to be less than 2.00 to 1.00 as of the end of any fiscal quarter.

- Profitability covenant – Heald covenanted that its consolidated net profit would not be less than $1.00 as of the end of any of its fiscal years. Heald also covenanted that its consolidated net income would not be less than $1.00 as of the end of any of its fiscal quarters.

BACKGROUND: The Authority issued Heald College Private Placement Revenue Bonds, Series 2003 (the “Bonds”) in the original aggregate amount of $9,800,000. The amount outstanding as of July 1, 2006 is $8,865,600. The Bonds were issued pursuant to a Financing Agreement between the Authority, Heald College and Wells Fargo Bank. All payments of principal and interest to date have been fully and timely made.

Heald management has informed the Authority and Wells Fargo Bank that it is in technical default of the covenants detailed above. In fiscal years 2004 and 2005, Heald experienced a substantial decrease in operating revenues. Adverse economic conditions and a general decline in the technology sector led to decreases in enrollment, which contributed to this revenue loss. Changes in senior management disrupted the implementation of corrective strategies further complicating Heald’s financial situation. Although Heald expects further losses in 2006, new management is taking steps to reorganize and financially stabilize the college. Steps being taken include cost-savings initiatives, downsizing and a strategic marketing plan.

Heald and Wells Fargo Bank are requesting the modification of covenants as detailed in the First Amendment to the Financing Agreement. Two of the covenants will be modified to give Heald a timeframe in which to stabilize their financial position. An additional covenant provides for target net income and net loss numbers that strengthen Wells Fargo Bank’s security. Execution of the First Amendment to the Financing Agreement will remove Heald from noncompliance currently, but requires that Heald perform to certain standards to remain in compliance with the amended covenants.

In addition to the $8,865,600 in outstanding Bonds, Heald has $13,085,000 outstanding from a 1999 Authority bond issuance bringing Heald's total outstanding Authority debt to $21,950,600. Staff reviewed Heald's 2005 audited financial statements and found that Heald maintains over $33 million in total net assets, the majority of which is unrestricted. In fiscal year 2005, its debt service coverage ratio was 1.29x, indicating Heald's ability to manage the repayment of debt. As security for these outstanding debts, the Authority holds first liens on real estate assets currently valued in excess of $50,000,000.

STAFF RECOMMENDATION: Staff recommends the Authority approve a resolution authorizing the First Amendment to the Financing Agreement for the Authority's Heald College Private Placement Revenue Bonds, Series 2003.

Exhibit A

The First Amendment to the Financing Agreement will contain the following provisions:

- Net loss after taxes not greater than:

  (i) $7,400,000.00 for the fiscal year-to-date period ending March 31, 2006;

  (ii) $13,500,000.00 for the fiscal year ending June 30, 2006;

  (iii) $400,000.00 for the fiscal quarter ending September 30, 2006; and

  (iv) $1,300,000.00 for the fiscal year-to-date period ending December 31, 2006;

- Net profit before taxes not less than $1,100,000.00

  (i) for the fiscal year-to-date period ending March 31, 2007 and

  (ii) at the end of each fiscal quarter thereafter for the fiscal year-to-date period then ended.

- Net profit after taxes of not less than $1 at the end of each fiscal quarter from and after June 30, 2007, in each case for the fiscal year-to-date period then ended.

- Total Liabilities divided by Tangible Net Assets not at any time greater than 1.75 to 1.0, with:

  (i) "Total Liabilities" defined as the aggregate of current liabilities and non-current liabilities less subordinated debt.

  (ii) "Tangible Net Assets" defined as the sum of Unrestricted Net Assets plus Temporarily Restricted Net Assets plus Permanently Restricted Net Assets plus subordinated debt minus "Software Development Costs" (as reflected as a separate line item in the Borrower's financial statements).

  (iii) "Unrestricted Net Assets" defined as assets not subject to donor-imposed stipulations and available to support the Borrower's operating activities.

  (iv) "Temporarily Restricted Net Assets" defined as assets subject to donor-imposed stipulations that they be maintained by the Borrower for a specified period of time but not permanently.

  (v) "Permanently Restricted Net Assets" defined as assets subject to donor-imposed stipulations that they be maintained permanently by the Borrower.

- EBITDA Coverage Ratio (in each case for the four consecutive fiscal quarter period then ended) not less than:

  (i) negative 2.50 to 1.0 at each of March 31, 2006 and June 30, 2006;

  (ii) negative 1.75 to 1.0 at each of September 30, 2006 and December 31, 2006;

  (iii) 0.50 to 1.0 at March 31, 2007; and

  (iv) 2.0 to 1.0 at June 30, 2007 and at the end of each fiscal quarter thereafter.

  With "EBITDA" defined as net profit before tax plus interest expense (net of capitalized interest expense), depreciation expense and amortization expense.

  With "EBITDA Coverage Ratio" defined as EBITDA divided by the aggregate of total interest expense plus the prior period current maturity of long-term debt and the prior period current maturity of subordinated debt.