

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

EXECUTIVE SUMMARY

<p>Applicant: Stanford Hospital and Clinics (“SHC”) Stanford, California (Santa Clara County)</p> <p>Facility Types: Acute care and specialty care facilities</p>	<p>Amount Requested: \$250,000,000</p> <p>Date Requested: April 24, 2003</p> <p>Requested Loan Term: 33 years</p> <p>Resolution Number: F- 296</p>																					
<p>Uses of Bond Proceeds: SHC seeks funds for ongoing construction, renovation, and equipment needs, including the completion of its cancer and ambulatory care center.</p>																						
<p>Type of Issue: Negotiated public offering with fixed and variable rates</p> <p>Credit Enhancement: Insurance may be obtained from FSA</p> <p>Expected Credit Rating: Portions With Insurance: AAA (S&P), Aaa (Moody’s) Portions Without Insurance: A- (S&P), A3 (Moody’s)</p> <p>Senior Underwriter: Bear, Stearns & Co. Inc.</p> <p>Bond Counsel: Orrick, Herrington & Sutcliffe LLP</p>																						
<p>Financial Overview: SHC is returning to profitability after an unsuccessful merger. The most significant improvement in SHC’s operations is an increase in patient service revenue, reflecting the effects of restructured reimbursement relationships. SHC exhibits balance sheet strength, including good liquidity. SHC will become leveraged with this financing, but a proforma debt service coverage ratio of 2.02x indicates an ability to manage this debt.</p>																						
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<p>Legal Review: No information was disclosed to question the financial viability or legal integrity of the Applicant.</p>																						
<p>Staff Recommendation: Staff recommends the Authority approve a Resolution in an amount not to exceed \$250,000,000 for Stanford Hospital and Clinics subject to a bond rating of at least an “A” category rating by a nationally recognized rating agency.</p>																						

STAFF SUMMARY AND RECOMMENDATION

Stanford Hospital and Clinics (“SHC”)

April 24, 2003

Resolution Number: F-296

I. PURPOSE OF FINANCING: SHC seeks funds for ongoing construction, renovation and equipment needs, including the completion of its cancer and ambulatory care center.

Construction/Renovation \$155,682,073

Construction of cancer/ambulatory care center.....\$100,751,385

SHC is currently constructing a new outpatient facility that will support its cancer programs, among others. The 220,000 square foot outpatient cancer and ambulatory treatment facility is expected to be opened in March 2004, equipped with state-of-the-art technology, to be located adjacent to Lucile Salter Packard Children's Hospital. This building will include new facilities for radiation oncology and gene therapies and an ambulatory treatment center that will permit patients undergoing or recovering from treatment to be accommodated for less than 24 hours.

Existing outpatient facilities are aging and reportedly close to capacity, and this outpatient center will provide the needed additional facilities to handle the growing demand.

This project is a continuation of the ambulatory care center building project funded with the Authority’s 1998B bonds.

SHC’s strategic plan calls for near-term intensive growth in services such as these in which SHC has demonstrated distinction.

This project includes \$30,415,000 in reimbursements.

Facility renovations \$43,761,685

SHC’s facilities are aging and in need of physical upgrade, including regulatory upgrades mandated by JCAHO. Included also are physical interior and exterior enhancements.

The project includes \$13,186,000 in reimbursements.

Seismic renovations \$11,169,003

These renovations are part of the approximately \$21 million that SHC estimates spending prior to 2008 to meet NPC-3 requirements.

This project includes \$3,249,000 in reimbursements.

Equipment/Information technology..... 56,686,000

SHC is planning needed upgrades to its equipment, including routine medical and other equipment and Information Technology infrastructure. Routine equipment includes medical, surgical and other aging equipment such as heating, ventilation and air conditioning systems; security systems; maintenance equipment and other equipment. SHC’s Information Technology systems are aging and have several components in need of upgrade, including billing systems, computers and overall network infrastructure.

This project includes \$11,815,000 in reimbursements.

Other financing costs are as follows..... 34,816,898

<i>Debt service reserve.....</i>	<i>\$17,127,045</i>
<i>Capitalized interest fund.....</i>	<i>15,526,103</i>
<i>Estimated issuance costs.....</i>	<i>2,163,750</i>

The new bond issue will allow SHC to capitalize interest and defer principal expense on the bonds until construction/renovation projects are completed and has begun to generate offsetting revenue.

If bond insurance is obtained, it is expected to cost approximately \$4 to \$5 million, which will be paid from SHC internal funds.

Total Uses of Funds..... \$247,184,971

Structure of Financing:

- Fixed and/or variable rate bonds (to be determined by market and availability of bond insurance) with a 33 year maturity date [if insurance is obtained, there will be one, fixed-rate bond; if no insurance is obtained, there will be a @ \$110M variable rate and @ \$140M fixed rate bond].
- Expected Credit Rating:
 - Portions With Insurance: AAA (S&P), Aaa (Moody’s).
 - Portions Without Insurance: A- (S&P), A3 (Moody’s) (A portion may go uninsured, dependent on market conditions).
- Negotiated public offering.
- Sole obligation of Stanford Hospital and Clinics.*

*See the “Background” section for a further description of this corporate entity as well as other entities that Stanford Hospital and Clinics has been affiliated with.

II. FINANCIAL STATEMENTS AND ANALYSIS

Stanford Hospital and Clinics and Subsidiaries Combined Statements of Operations (\$000's) (Unrestricted)

	For the 6 months ended Feb. 28, 2003 (Unaudited)	For the year ended August 31,	
		2002	2001 (Restated)
Unrestricted Revenue:			
Net patient service revenue	\$ 455,416	\$ 859,919	\$ 731,824
Premium revenue	10,656	39,543	60,871
Other revenue	7,618	14,295	11,668
Investment income	1,379	4,290	17,585
Net assets released from restrictions	7,134	3,673	4,253
Total revenues, gains, and other support	<u>482,203</u>	<u>921,720</u>	<u>826,201</u>
Expenses:			
Salaries and benefits	204,799	389,329	367,256
Professional services	11,207	23,503	22,135
Supplies	67,556	127,213	118,242
Purchased services ⁽²⁾	109,167	214,004	210,118
Provision for doubtful accounts	46,622	80,742	66,691
Depreciation	13,663	37,282	64,989
Interest	4,455	9,858	11,683
Other	15,109	27,299	5,249
Total expenses	<u>472,578</u>	<u>909,230</u>	<u>866,363</u>
Excess of revenues, gains, and other support over expenses	9,625	12,490	(40,162)
Other	<u>5,162</u>	<u>701</u>	<u>(8,837)</u>
Increase in unrestricted net assets	14,787	13,191	(48,999)
Unrestricted net assets, beginning of year	159,003	145,812 ⁽¹⁾	194,811
Unrestricted net assets, end of year	<u>\$ 173,790</u>	<u>\$ 159,003</u>	<u>\$ 145,812</u>

⁽¹⁾ The beginning balance, on September 1, 2001, of unrestricted net assets was \$285,431,000. On September 1, 2001, the net assets of LPCH were transferred from SHC to the University, leaving a balance of \$145,812,000.

⁽²⁾ Purchased services includes payments to physicians with the School of Medicine. Corresponding professional service revenue is reported in patient service revenues.

Stanford Hospital and Clinics and Subsidiaries
Consolidated Statements of Financial Position (\$000's)

	As of August 31,		
	As of Feb. 28	2002	2001
<u>Assets</u>	(Unaudited)		(Restated)
Current Assets:			
Cash and cash equivalents	\$ 101,042	\$ 71,800	\$ 62,505
Assets limited to use, held by trustee	10,049	25,280	41,783
Patients accounts receivable, net	113,311	126,694	124,777
Other receivables	4,157	7,744	7,047
Inventories	9,793	8,950	9,301
Prepaid expenses and other	3,235	1,624	2,164
Due from related parties	21,693	5,915	-
Total Current Assets	263,280	248,007	247,577
Investments	165,597	179,526	157,292
Property and equipment, net	194,685	183,744	169,927
Other assets	12,307	16,964	11,816
Total Assets	\$ 635,869	\$ 628,241	\$ 586,612
 <u>Liabilities & Net Assets</u>			
Current Liabilities:			
Accounts payable and accrued liabilities	\$ 41,539	\$ 61,866	\$ 46,157
Accrued salaries and related benefits	44,680	49,323	38,564
Due to related parties	18,680	7,330	13,621
Third party payor settlements	39,421	42,465	36,503
Current portion of long term debt	2,800	2,800	2,670
Self-insurance reserves, current	17,348	15,918	16,989
Total current liabilities	164,468	179,702	154,504
Self-insurance reserves, net of current portion	106,153	86,156	83,614
Long-term debt, net of current portion	180,665	183,465	186,265
Total Liabilities	451,286	449,323	424,383
Minority Interest	(231)	-	-
Unrestricted net assets	173,790	159,003	145,812
Temporarily restricted net assets	9,458	18,349	14,326
Permanently restricted net assets	1,566	1,566	2,091
Total Net Assets	184,814	178,918	162,229
Total Liabilities & Net Assets	\$ 635,869	\$ 628,241	\$ 586,612

Financial Ratios:

Proforma ^(a)

Debt Service Coverage (x)	2.02	4.79	3.62
Debt/Unrestricted Net Assets (x)	2.74	1.17	1.11
Margin (%)		1.43%	-2.86%
Current Ratio (x)		1.38	1.44

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

Financial Discussion:

Stanford Hospital is returning to profitability after an unsuccessful merger.

During the 29 months of the merger that ended March 31, 2000, UCSF Stanford Health Care lost a combined \$176 million. Per the merger agreement, the losses were split approximately in half. Steps were taken to disassociate with UCSF including delegating each series of a 1998 bond financing to the proper party. Further, on September 1, 2001 (the first day of the 2001-02 fiscal year), control of LPCH was transferred from SHC to Stanford University, and effective March 2003, LPCH withdrew from the obligated group. This was done to enable the two parties to undertake future financings as separate and distinct entities.

According to management, losses in the remainder of 2000 and in 2001 further eroded net assets. Those losses resulted from an unfavorable service mix, inadequate reimbursement rates, high labor and professional service costs, reduced non-operating revenue from investments and other sources, expenses incurred to restore infrastructure and staff after the termination of operations by UCSF Stanford Health Care and the impact of a 53-day nursing strike in June and July 2000.

The lingering effects of this transition are evident in the operating results through 2001.

A new management team was instituted in 2001 and 2002. Management attributes the turnaround to:

- Repositioning its managed care relationships. During 2001, substantially all non-Medicare contracts with payors were re-negotiated, capitation risk was eliminated from all contractual relationships and replaced with either per diem payments, discounted fee for service payments, or case rate payments.
- Shifting of focus in services, including termination of certain less profitable lines of service.
- Strengthened financial reporting and controls.
- Consecutive years of turn-around budgets, including an initiative commencing in 2001 to reduce employee hours per patient day.

The most significant improvement in SHC's operations is an increase in patient service revenue, reflecting the effects of restructured reimbursement relationships.

SHC returned to profitability in fiscal 2002 primarily due to an 18% increase in net patient service revenue (approximately \$128 million), largely attributable to the elimination of capitation from all non-Medicare contracts. Operating expenses were kept in check in this period, increasing by 8% compared with a 12% increase in total revenue. Personnel expenses, which increased by 6%, may be expected to remain stable in the near future as the contract with registered nurses is in place until March 2004 and with supporting staff through 2005.

As has been true throughout its existence, SHC is aided by its relationship with a strong and stable institution (Stanford University).

SHC exhibits balance sheet strength, including good liquidity.

SHC is liquid, as shown by a current ratio of 1.30x, which will be strengthened with the reimbursement of project expenditures from this financing.

Following the large unrealized loss in 2001, management has shifted the portfolio to more conservative investments.

Stanford Hospital and Clinics will become leveraged with this financing, but a proforma debt service coverage ratio of 2.02x indicates an ability to manage this debt.

SHC's debt to unrestricted net asset ratio will increase significantly with this financing, from 1.17x to 2.74x. Debt service coverage, however, is projected to be a manageable 2.02x.

III. BACKGROUND: SHC is the principal teaching affiliate of the Stanford University School of Medicine in providing primary and specialty health services to adults. It operates Stanford Hospital, offering services in the fields of cardiac care, cancer treatment, organ transplantation, neurological services and other tertiary care to adult patients. With its sister corporation Lucile Salter Packard Children's Hospital at Stanford ("LPCH"), SHC operates the clinical settings through which the School of Medicine educates medical and graduate students, trains residents and clinical fellows, supports faculty and community clinicians and conducts medical and biological sciences research.

The principal clinical facilities of SHC are a 594 licensed bed tertiary and quaternary specialty hospital and the primary and specialty clinics in which the faculty of the School of Medicine and community physicians provide clinical services. The hospital and clinics are located on the campus of Stanford University adjacent to its School of Medicine in Palo Alto.

SHC has operated hospital facilities in Palo Alto continuously since 1958, except for the period from November 1997 through March 2000. During that period, the Hospital and Clinics were operated in a joint venture with The Regents of the University of California.

In 1997, Stanford University and The Regents of the University of California agreed to combine the separate health care facilities and services of the SHC, LPCH and the University of California, San Francisco ("UCSF") into a single clinical enterprise under the control of UCSF Stanford Health Care, organized with Stanford and the University of California as members. SHC transferred substantially all its assets, liabilities and operations to UCSF Stanford Health Care. In connection with this combination, UCSF Stanford Health Care replaced SHC as a Member of the Obligated Group created under the existing Master Indenture and LPCH became a Member of the Obligated Group.

Two years later, Stanford and the University of California agreed to terminate their affiliation. 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, including the Series 1998B Bonds. SHC replaced the UCSF Stanford Health Care as a Member of the Obligated Group.

Subsequently, SHC and LPCH agreed that LPCH would withdraw from the Obligated Group to enable the SHC and LPCH to undertake future financings as separate and distinct credits. Pursuant to the provisions of the Master Indenture, LPCH withdrew from the Obligated Group effective March 11, 2003, leaving SHC as the sole member of the Obligated Group. Three Obligations (the “LPCH Obligations”) were issued under the Master Indenture in 1998 in order to secure certain obligations of LPCH in connection with certain tax-exempt debt issued for the benefit of LPCH in 1993. SHC remains liable on the LPCH Obligations. LPCH and SHC have entered into an agreement pursuant to which LPCH has agreed to reimburse SHC in the event that SHC is required to make a payment with respect to any of the LPCH Obligations. Refunding of LPCH’s Obligations is not part of the current plan and SHC’s responsibility has not been eliminated.

Stanford University is the sole member of the corporation and SHC is solely responsible for the payment of principal and interest on the 2003 bonds. Neither Stanford University nor LPCH is obligated to pay debt service.

SHC owns two subsidiaries, which are included in its consolidated financial statements. SHC Professional Insurance Company, Inc. provides liability coverage for medical, professional, hospital, general and employment practices liability. Menlo Health Alliance operates a multi-specialty medical clinic. SHC also holds 45% of the limited partner units in the Waverly Surgery Center L.P., with Alpine Healthcare LLC as general partner. SHC and the University are the members of Stanford PET-CT, LLC which provides radiological services.

There are certain operational relationships among the School of Medicine, SHC and LPCH. There is a professional services agreement through which SHC bills and collects for professional services provided at the hospital and clinics by the School of Medicine faculty physicians and compensates the School of Medicine for such services. Also, SHC and LPCH share certain departments, including information systems, human resources, managed care contracting, payroll and materials management.

Service Area and Competition: SHC identifies its local market as San Mateo and Santa Clara counties, which is the source of approximately 65% of its inpatient volume. SHC accounts for the greatest number of hospital discharges of the 21 hospitals in this market, comprising approximately 10% of the total. Its competitors include Santa Clara Valley Medical Center, Mills-Peninsula Medical Center, and Good Samaritan Hospital. In addition to enhancing its market presence with specialty care in local clinics, SHC expects a significant increase of patients from the national and international markets seeking SHC’s expertise in the most complex treatments.

Licenses and Contracts: The California Department of Health Services licenses the Hospital as a general acute care facility. Stanford Hospital and Clinics is certified as a provider of care for beneficiaries of the Medicare and Medi-Cal programs. Stanford Hospital and Clinics received its most recent full three-year accreditation from the Joint Commission on Accreditation of Health Care Organizations in March 2001 and is due for a routine triennial accreditation visit in Spring of 2004.

SHC contracts with all major health plans organized and operating in its service area. SHC has cancelled most of its fixed fee or capitation agreements.

IV. UTILIZATION STATISTICS:

	Stanford Hospital and Clinics				
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>5 months ended 1-31-02</u>	<u>5 months ended 1-31-03</u>
Admissions					
Acute	20,019	19,586	19,299	8,152	7,454
Behavioral Health	755	967	901	355	359
Rehab/SNF	<u>278</u>	<u>258</u>	<u>273</u>	<u>103</u>	<u>97</u>
Total	21,052	20,811	20,473	8,610	7,910
Patient Days					
Acute	92,518	98,443	102,388	41,687	40,440
Behavioral Health	6,518	8,477	7,940	3,200	3,490
Rehab/SNF	<u>3,776</u>	<u>3,580</u>	<u>3,683</u>	<u>1,498</u>	<u>1,336</u>
Total	102,812	110,500	114,011	46,385	45,266
Average Daily Census					
Acute	253.5	269.7	280.5	272.5	264.3
Behavioral Health	17.9	23.2	21.8	20.9	22.8
Rehab/SNF	<u>10.3</u>	<u>9.8</u>	<u>10.1</u>	<u>9.8</u>	<u>8.7</u>
Total	281.7	302.7	312.4	303.2	295.9
Average Length of Stay					
Acute	4.6	5.0	5.3	5.1	5.4
Behavioral Health	8.6	8.8	8.8	9.0	9.7
Rehab/SNF	13.6	13.9	13.5	14.5	13.8
Total	4.9	5.3	5.6	5.4	5.7
Emergency room visits	38,226	39,530	38,323	15,594	15,716
Short Stay Outpatient procedures	26,944	28,710	30,898	10,736	8,681
Other Outpatient accounts	222,152	267,098	250,459	113,870	110,299
Surgeries (includes LPCH)					
Inpatient	11,359	11,275	12,162	4,923	4,975
Outpatient	<u>13,858</u>	<u>13,479</u>	<u>13,363</u>	<u>5,666</u>	<u>4,560</u>
Total	25,217	24,754	25,525	10,589	9,535

Although admissions are declining, the average daily census has been increasing. Per SHC, declining admissions indicates that it is delivering an increasing amount of care in outpatient rather than inpatient settings and also reflects a trend of its local market. During that time, the average length of stay has been increasing, reflecting SHC's role as a referral center for complex cases.

V. SECTION 15438.5 OF THE ACT (Savings Pass Through): According to management, the savings resulting from the use of tax-exempt financing will enable SHC to keep costs low and to prevent price increases.

VI. SECTION 15459.1 (b) OF THE ACT (Community Service Requirement): The applicant has submitted the Certificate and Agreement Regarding Community Service Obligation with this application as required by the Act. SHC has also submitted its physicians list dated March 28, 2003 as required by Section 15459.1(b) of the Act.

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. SHC’s management states it has met all requirements to date, and anticipates meeting all future obligations. SCH estimates it will spend approximately \$21 million for seismic upgrades and expects to pay for such expenses from internal and external funds, including \$11 million from this financing.

VIII. OUTSTANDING DEBT: As of August 31, 2002, the outstanding debt issued through the Authority for SHC was \$186,265,000. Following the proposed financing, SHC will have outstanding approximately \$436,265,000 of Authority debt. The composition of SHC’s total long-term debt structure is as follows:

<u>Date Issued:</u>	<u>Original Amount</u>	<u>Amount Outstanding As of 8/31/02</u>	<u>Estimated Amount Outstanding after Proposed Financing</u>
<u>Existing Authority Debt:</u>			
Series 1998B *	\$193,895,000	\$186,265,000	\$186,265,000
<u>Proposed Authority Debt</u>			
2003 Series A			250,000,000
Total Debt		\$186,265,000	\$436,265,000

- Series 1998B bonds were a joint and several obligation of SHC and LPCH. Proceeds, however, were used for SHC projects. LPCH has withdrawn from the obligated group as of March 2003 leaving SHC as the sole obligor.

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 \$250,000,000 for Stanford Hospital and Clinics subject to a bond rating of at least an “A” category rating by a nationally recognized rating agency.