CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY
Downey Regional Medical Center-Hospital, Inc.
Amendment to Loan Agreement and Indenture

Staff Summary of
Resolution no. 2004-02

February 26, 2004

ISSUE:

The existing Loan Agreement for the 1993 Series Downey Regional Medical Center-Hospital, Inc. (formerly Downey Community Hospital Foundation) ("Downey") requires the hospital to retain the services of a third-party management consultant when the debt service coverage ratio falls below 1.10. Downey has retained the services of a management consultant, but is requesting that the Authority agree to waive the requirement of re-hiring third-party management consultants for the years ending 2004 and 2005 which will provide sufficient time for the recommendations that have already been implemented and eliminate the additional cost that would be incurred in subsequent years. As part of its proposal, Downey has agreed to grant a security interest in its gross operating revenues and to call additional bonds in 2004 and 2005 if the 1.10 debt service coverage ratio is not met for those fiscal years.

BACKGROUND:

The Authority approved the issuance of the 1993 Series bonds for Downey in an aggregate amount of $68,845,000 on July 29, 1993, for the purposes of construction, equipment purchases, refinancing and reimbursement. The uninsured serial and term bonds were issued in August 1993 and currently, $46,720,000 remains outstanding.

Although Downey has made all principal and interest payments in a timely manner, losses in 2001, 2002, and 2003 contributed to an insufficient debt service coverage ratio. Downey engaged a third-party management consultant, the Camden Group ("Camden"), when the debt service coverage ratio fell below 1.10 for 2001 and each subsequent year. Based upon Camden's recommendations, Downey implemented several operational changes including: 1) discontinuing certain unprofitable capitated agreements, including cancellation of all capitated contracts with CareMore Medical Group in fiscal 2002, 2) increasing rates in its PPO and commercial contracts, 3) entering into contractural affiliations with several medical groups to increase hospital services, and 4) downsizing its operations and cutting costs hospital wide. While the new rates and business restructuring is expected to result in improved financial results, Downey management believes that the full impact of these changes will not be evident until the end of fiscal year 2005.

Based on negotiations with the holders of the bonds and the trustee and in consultation with Orrick, Herrington & Sutcliffe LLP, as Bond counsel for the Authority, Downey is proposing amendments to the Loan Agreement and Indenture that enable the hospital to forgo the requirement of re-hiring a third-party management consultant through fiscal year end 2005 and require Downey to redeem $3.535 million in bonds on November 15, 2004 and $3.5 million in bonds on November 15, 2005 if the hospital fails to meet the debt service coverage ratio for fiscal year ending June 30 of the respective year. While Downey has earmarked the approximate $7 million in investment funds, from a December 31, 2003 investment balance of $75.6 million in the event of potential bond calls, the hospital also proposes to amend the Loan Agreement to grant a security interest in its gross operating revenues.

STAFF RECOMMENDATION:

Staff recommends the Authority approve the proposed changes to the Indenture and Loan Agreement that waive the requirement for Downey to re-hire a third-party management consultant through fiscal year end 2005 and require a partial redemption of bonds in 2004 and 2005 if Downey does not meet the 1.10 debt service requirement for each respective fiscal year.