

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

(CHFFA)

EXECUTIVE SUMMARY

Applicant: Sutter Health (Obligated Group) Sacramento, California (Sacramento County)		Amount Requested: \$958,000,000	
Project sites: See pages 2-4 for listing		Date Requested: March 29, 2007	
Facility Types: General acute/subacute and outpatient care		Requested Loan Term: 40 years	
Obligated group: The Obligated Group is identified on page 9, and will have approximately \$1.4 billion of Authority debt outstanding after the proposed financing.		Resolution Number: 322	
Uses of Bond Proceeds: Bond proceeds will be used for construction/renovation, the purchase of equipment and the refunding of existing debt.			
Type of Issue: Negotiated public offering with fixed rate and variable rate securities			
Credit Enhancement: Bond insurance for certain auction rate notes (FSA, FGIC and AMBAC)			
Expected Credit Rating: Aaa/AAA (insured) Moody's/S&P Aa3/AA- (anticipated underlying or uninsured) Moody's/S&P			
Senior Underwriter: Morgan Stanley			
Bond Counsel: Orrick, Herrington and Sutcliffe LLP			
Financial Overview: Sutter's income statement exhibits solid operating results with positive net income over the past three fiscal years along with continued revenue growth. Sutter's balance sheet is solid with a strong debt service coverage ratio and growing net assets.			
Sources of Revenue: (\$millions) (FYE 12/31/05)		<u>Amount</u>	<u>Percent</u>
Patient service revenues		\$5,244	81.0%
Capitation revenues		885	13.6%
Investment income		87	1.3%
Contribution		5	0.0%
Other		<u>269</u>	<u>4.1%</u>
Total revenues, gains and other support		<u>\$6,490</u>	<u>100.0%</u>
<u>Estimated Sources of Funds:</u>		<u>Estimated Uses of Funds:</u>	
Par amount of CHFFA bonds	\$958,000,000	Construction/renovation	\$791,000,000
Trustee held funds	7,940,000	Refunding	170,798,000
Sutter's equity	<u>10,203,500</u>	Financing costs	<u>14,345,500</u>
Total Sources	<u>\$976,143,500</u>	Total Uses	<u>\$976,143,500</u>
Legal Review: Staff has reviewed the applicant's responses to the questions contained in the Legal Status portion of the application. The information that was disclosed does not appear to question the financial viability or legal integrity of this applicant.			
Staff Recommendation: Staff recommends the Authority approve a Resolution in an amount not to exceed \$958,000,000 for Sutter Health subject to a bond rating of at least an "A" category rating by a nationally recognized rating agency.			

STAFF SUMMARY AND RECOMMENDATION

**Sutter Health
(Obligated Group)**

March 29, 2007

Resolution Number: 322

I. PURPOSE OF FINANCING:

Sutter seeks to invest approximately \$791 million in projects in Northern California, including a new medical office building, construction of replacement hospitals to meet seismic requirements and expansion of existing facilities. Bond proceeds will be used to construct, renovate and purchase equipment for a variety of facilities in several locations.

In addition, Sutter plans to use approximately \$171 million in bond proceeds to refund long term debt on a current basis. The refunding will be issued as auction rate variable bonds, replacing variable demand bonds containing a put provision as well as certain callable fixed rate bonds.

Construction/Renovation\$791,000,000

Mills-Peninsula Health Services.....\$508,400,000

The replacement of Mills-Peninsula Health Services Peninsula Hospital is necessary to comply with SB 1953, which requires hospitals to meet seismic safety requirements. The new 600,000 square foot project will include a 243 bed hospital which will replace Peninsula Hospital, which was built in 1954 & 1960. The parking structure is approximately 75% completed, while the hospital is approximately 30% completed. The project is estimated to cost \$528 million.

California Pacific Medical Center – Davies\$140,000,000

The Davies Campus will be seismically retrofitted to meet California state seismic requirements. The project will allow for expansion of the acute rehabilitation program at Davies, renovation of the Central Kitchen, and the addition of new MRI equipment. The project, which is about 25% completed, is estimated to cost \$186 million.

Sutter Roseville Medical Center\$69,100,000

Sutter Roseville Medical Center will expand its neonatal intensive care capability with a single story addition to the existing acute care hospital. The 9,500 square foot building is approximately 25% completed. The project is expected to be in service by May 2008 and is estimated to cost \$10.5 million.

The Acute Rehab and Vent programs will be housed in an approximately 107,000 square foot facility, at a total estimated cost of \$58.6 million. The Acute Rehab unit will focus on brain and spinal cord injury, stroke and neurology conditions, and orthopedic trauma. The first floor of the new building will house 56 private Acute Rehab beds while the second floor will

house a 30 private bed Vent unit. The project is approximately 25% completed, with full completion expected by November 2008.

Memorial Hospitals Association.....\$20,000,000

The master plan is to expand the capacity of Memorial Medical Center to accommodate population growth. The expansion includes additional ED, OB, and NICU beds, and expanded surgery department capacity. Sutter will require \$20 million to complete the project bringing the overall cost estimated at over \$170 million. The anticipated completion date is March 2008.

Sutter Amador Hospital\$18,200,000

This project will enable Sutter Amador, the sole community provider in Jackson, to address current and future needs. The first floor will offer a comprehensive Imaging Center, a laboratory, a diabetes clinic, a community conference center, and hospital support functions. The second floor will include a Women's Health Center, an endoscopy suite, an infusion center, as well as administrative services. The 47,375 square foot building, at a total cost of approximately \$22.7 million, is expected to be completed in December 2006.

Sutter Gould Medical Foundation\$35,300,000

Sutter Gould Medical Foundation is nearing completion on a 39,000 square foot clinic to house physicians. Bringing ancillary services in-house will allow physicians to provide more convenient, full-service care to patients, and reduce the need for Stockton residents to travel to Modesto or elsewhere. The project, is approximately 25% completed, and is expected to be completed by April 2007. The total cost of the project is expected to be approximately \$39.3 million.

Refunding..... **170,798,000**

CSCDA Series 1995 Variable Rate Certificates\$40,500,000

The CSCDA Series 1995 Variable Rate Certificates were used to construct a 315,000 square foot replacement facility for Roseville Community Hospital (Roseville) and to construct a 65,000 square foot 30 bed short stay facility at Sutter Maternity and Surgery Center of Santa Cruz (Santa Cruz).

CHFFA Sutter/CHS Series 1996A/1996B Bonds.....\$58,355,000

CHFFA Sutter/CHS Series 1996A Bonds were used to refund the Pacific Presbyterian Medical Center and Children's Hospital of San Francisco Bonds. CHFFA Sutter/CHS Series 1996B Bonds were used to refund Sutter Lakeside Hospital bonds.

CHFFA Summit Medical Center Series 1996A Bonds\$40,560,000
 CHFFA Summit Medical Center Series 1996A Bonds were used to refund Series 1985A Bonds, 1989A Bonds, 1989B Bonds which were used to fund construction, equipment acquisition, refinance a promissory note and finance acquisition of certain capital equipment.

CHFFA Series 1991A and 1991B Bonds\$31,383,000
 Sutter seeks to prepay a loan due to mature on July 1, 2007 funded from this Revolving Pooled Loan bond issue which was used for construction of capital projects at Sutter General Hospital (Sacramento).

Financing Costs**14,345,500**

Bond insurance\$ 8,000,000
Underwriters discount4,560,463
Cost of issuance1,785,037

Total Uses of Funds.....**\$976,143,500**

Structure of Financing:

- Negotiated public offering, fixed rates and variable rates
- Credit enhancement: Bond insurance for certain auction rate notes (FSA, FGIC and AMBAC)
- Expected Credit Rating: Aaa/AAA (insured) Moody's/S&P Aa3/AA- (anticipated underlying or uninsured) Moody's/S&P
- General obligation of Obligated Group Members
- Joint and several obligation of the Sutter Health Obligated Group (see Page 9 for a listing of Obligated Group)
- Debt service coverage (DSC) of 1.10x as described in the Master Indenture dated August 1, 1985.

II. FINANCIAL STATEMENTS AND ANALYSIS:

SUTTER HEALTH OBLIGATED GROUP Combined Statements of Operations (millions)

	December 31,		
	2005	2004	2003
Unrestricted revenues, gains and other support:			
Patient service revenues	\$ 5,244	\$ 4,888	\$ 4,435
Capitation revenues	885	868	793
Investment income	87	91	63
Contributions	5	3	-
Other	269	267	244
Total revenues, gains and other support	<u>6,490</u>	<u>6,117</u>	<u>5,535</u>
Expenses:			
Salaries and employee benefits	2,782	2,564	2,286
Purchased services	1,243	1,180	1,046
Supplies	752	696	622
Depreciation and amortization	301	266	245
Capitated purchased services	259	260	256
Provision for bad debts	248	245	229
Rentals and leases	83	77	73
Interest	53	52	58
Insurance	50	74	69
Other	253	249	188
Total operating expenses	<u>6,024</u>	<u>5,663</u>	<u>5,072</u>
Income	466	454	463
Unrestricted net assets:			
Change in net unrealized gains and loss on investments	(18)	1	82
Net assets released from restrictions			
used for equipment acquisition	7	8	8
Donated long-lived assets	9	11	4
Equity transfers between related entities	(55)	(76)	(41)
Cumulative effect of change in accounting principle	(64)	-	-
Change in additional minimum pension liability	-	-	41
Other	7	7	4
Total unrestricted net assets	<u>(114)</u>	<u>(49)</u>	<u>98</u>
Increase in unrestricted net assets	352	405	561
Decrease in temporarily restricted net assets	(4)	(2)	(6)
Increase/(decrease) in permanently restricted net assets	-	1	1
Increase in net assets	<u>348</u>	<u>404</u>	<u>556</u>
Net assets, beginning of year	2,612	2,208	1,652
Net assets, end of year	<u>\$ 2,960</u>	<u>\$ 2,612</u>	<u>\$ 2,208</u>

SUTTER HEALTH OBLIGATED GROUP
Combined Balance Sheets
(millions)

	December 31,		
	2005	2004	2003
Assets			
Current assets:			
Cash and cash equivalents	\$ 186	\$ 64	\$ 44
Short-term investments	608	674	639
Patient accounts receivable, net	809	731	747
Other receivables	88	77	70
Inventories	71	65	56
Other current assets	188	136	145
Total current assets	1,950	1,747	1,701
Non-current investments	989	921	740
Property, plant and equipment, net	2,695	2,296	1,947
Other assets	166	166	112
Total assets	\$ 5,800	\$ 5,130	\$ 4,500
Liabilities and net assets			
Current liabilities:			
Current maturities of long-term obligations	\$ 23	\$ 24	\$ 26
Accounts payable and accrued expenses	797	710	706
Current portion of estimated third-party settlements	6	1	15
Total current liabilities	826	735	747
Non-current liabilities:			
Long-term obligations, less current maturities	1,609	1,449	1,332
Other	405	334	213
Net assets:			
Unrestricted	2,881	2,529	2,124
Temporarily restricted	69	73	75
Permanently restricted	10	10	9
Total liabilities and net assets	\$ 5,800	\$ 5,130	\$ 4,500

Financial Ratios:

	Proforma ^(a)			
Debt Service Coverage (x)	5.23	9.29	9.51	10.29
Debt/Unrestricted Net Assets (x)	0.72	0.57	0.58	0.64
Margin (%)		7.18	7.42	8.36
Current Ratio (x)		2.36	2.38	2.28

^(a) Recalculates December 31, 2005 results to include the impact of this proposed financing.

Financial Discussion:

Sutter's income statement exhibits solid operating results with positive net income over the past three fiscal years along with continued revenue growth.

Sutter's income statement exhibits solid profitability over our review period with operating income remaining steady from \$463 million in fiscal year 2003 to \$466 million in fiscal year 2005. In addition, Sutter has shown strong margins of 8.36%, 7.42%, and 7.18% for fiscal years 2003, 2004 and 2005 respectively. Sutter's revenues consist primarily of net patient service revenue accounting for approximately 81% of total revenues in fiscal year ending 2005. Total revenue increased from \$5.5 billion in fiscal year 2003 to \$6.4 billion in fiscal year 2005, an increase of 17%. This increase came as a result of favorable change in commercial payer mix. According to management, a decline in capitated lives and an increase in PPO-covered patients have yielded higher reimbursement. Sutter continues to keep total expenses in line with revenues, increasing from \$5.1 billion in fiscal year 2003 to \$6.0 billion in fiscal year 2005, an increase of 20%.

Sutter's balance sheet is solid with a strong debt service coverage ratio and growing net assets.

Sutter's current balance sheet is solid as cash and cash equivalents increased from \$44 million in fiscal year 2003 to \$186 million in fiscal year 2005. Net property, plant and equipment increased by 38% (from \$1.9 billion in fiscal year 2003 to \$2.7 billion in fiscal year 2005) reflecting a substantial investment in technology and hospital renovations. A proforma debt service coverage ratio of 5.23x indicates that Sutter can manage the additional debt.

III. BACKGROUND:

Sutter Health (Sutter Health), a California non-profit public benefit corporation, is the “parent” of the Sutter Health system (comprised of Sutter Health and its affiliated health care organizations) (the “System”), which operates primarily in Northern California. The System provides a broad range of health care services, including acute, sub-acute, long-term, home health and outpatient care, as well as physician delivery systems. These services are provided through an integrated health care delivery system that has the ability to deliver a full range of health care products and services to the communities it serves.

Sutter Health’s affiliated physician organizations, hospitals, home care and other programs provide many services to those in need of care, regardless of their ability to pay. The System’s community benefit activities include providing care for which the System was not paid or was underpaid and the unpaid costs of providing health screenings, free clinics and other health-related services, educating the community with various seminars and performing medical research.

The System currently includes the following health care facilities and providers:

- Twenty-seven acute care hospital facilities (two of which are acute care psychiatric hospitals), represent 25 licenses and three skilled nursing facilities (including one free-standing facility) with a total of 5,037 licensed acute care bed and 787 licensed skilled nursing beds
- Seven nonprofit medical foundations with approximately 1,452 full time equivalent physicians
- Nine home health care providers
- One wholly-owned management service organization providing support to medical groups and five aligned independent practice associations.

The Obligated Group is the central financing vehicle and the basis of the underlying credit rating for the System. The Obligated Group includes 28 non-profit corporations that either own or lease and operate 27 acute care hospital facilities as well as seven nonprofit medical foundations.

Most of the System’s affiliated health care organizations are located within one of five service areas, with the remaining affiliated health care organizations operating as “Freestanding Affiliates.” This structure permits each affiliated health care organization to provide health care services that are responsive to local needs and issues, while preserving the benefits of a large integrated health care provider and implementing the System’s strategic objectives. Each service area, as well as each Freestanding Affiliate, is organized to coordinate the activities of acute and non-acute care operations, physician delivery systems and other activities. The Freestanding Affiliates provide services to Sonoma, Lake, Amador, Del Norte, Curry (Oregon), Yuba and Sutter Counties and the State of Hawaii. The System’s five main service areas include:

Peninsula Coastal Service Area: San Mateo, Santa Clara and Santa Cruz Counties
East Bay Service Area: Solano, Contra Costa and Alameda Counties
West Bay Service Area: City and County of San Francisco; Marin County
Sacramento Sierra Region: Sacramento, Yolo, Placer, Nevada and El Dorado Counties
Central Valley Area: Stanislaus, Merced and San Joaquin Counties

The Obligated Group Members are currently as follows:

Sutter Health
Alta Bates Summit Medical Center
Berkeley Long-Term Care Company
California Pacific Medical Center
Eden Medical Center
Marin Community Health
Marin General Hospital
Marin Home Care, Inc.
Memorial Hospitals Association
Memorial Hospital Los Banos
Mills-Peninsula Health Services
Novato Community Hospital
Palo Alto Medical Foundation for Health Care, Research and Education
Sutter Amador Hospital
Sutter Coast Hospital
Sutter Delta Medical Center
Sutter Gould Medical Foundation
Sutter Health Sacramento Sierra Region
Sutter Lakeside Hospital
Sutter Maternity and Surgery Center of Santa Cruz
Sutter Medical Center of Santa Rosa
Sutter Merced Medical Center
Sutter Solano Medical Center
Sutter Tracy Community Hospital
Sutter Visiting Nurse Association and Hospice
St. Luke's Hospital
Sutter North Medical Foundation
Sutter Medical Foundation

Service Area and Competition: Sutter is California's second largest health system with 27 acute care hospitals (5,037 licensed beds), three skilled nursing facilities, seven nonprofit medical foundations (1,452 full time equivalent physicians), and other related entities. Sutter's key markets in San Francisco, East Bay, Sacramento, and Marin County are highly competitive, with Kaiser and Catholic Healthcare West as the primary competition.

Licenses and Contracts: All Sutter Health affiliated hospitals are licensed by the Department of Health Services. Sutter Health's Obligated Group members participate in the Medicare and the Medi-Cal program and provide a full range of services to Medicare and Medi-Cal patients.

IV. UTILIZATION STATISTICS:

Sutter Health Obligated Group

	<u>Year Ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
Current Licensed Beds	5,147	5,107	5,007
Beds in Service	4,521	4,528	4,422
Admissions	227,634	231,918	228,351
Patient Days	1,091,808	1,089,540	1,063,937
Average Length of Stay	4.8	4.7	4.7
% Occupancy Based on Beds in Service	66.2%	65.7%	65.9%
Emergency Room Visits	761,681	721,731	714,476

V. OUTSTANDING DEBT:

As of December 31, 2005, Sutter Health's long-term debt totaled \$1.6 billion, of which over \$593 million (37%) was comprised of debt issued through this Authority. Following this proposed financing, Sutter Health's total debt will equal approximately \$2.4 billion, with the amount of Authority debt increasing to over \$1.4 billion (58% of Sutter Health's total debt).

Sutter Health Obligated Group

<u>Bond Issue Name</u>	<u>Original Issue Amount</u>	<u>Amount Outstanding as of 12/31/05*</u>	<u>Estimated Amount Outstanding After Proposed Financing</u>
<i>Existing Authority Debt</i>			
Memorial Hospitals Assn., Series 1982	\$ 4,350,000	\$ 4,350,000	\$ 4,350,000
Adventist-Sutter Pool			
Series 1991A&B	31,383,000	31,383,000	-0-
Sutter/CHS, Series 1996A	51,500,000	34,220,000	-0-
Sutter/CHS, Series 1996B	42,500,000	30,100,000	-0-
Summit Medical Ctr, Series 1996A	75,920,000	45,750,000	-0-
Sutter Health, Series 1997A	37,805,000	11,215,000	11,215,000
Sutter Health, Series 1997C	88,660,000	70,585,000	70,585,000
Sutter Health, Series 1998A	175,000,000	175,000,000	175,000,000
Sutter Health, Series 1999A	138,000,000	138,000,000	138,000,000
Sutter Health, Series 2000A	52,000,000	<u>52,000,000</u>	<u>52,000,000</u>

	\$ 592,603,000	\$ 451,150,000
<i><u>Other Debt</u></i>		
CSCDA Hospital Revenue Bonds		
Certificates of Participation,	\$1,017,023,000	\$976,523,000
City of Modesto		
Hospital Revenue Bonds	19,845,000	19,845,000
Other long-term obligations	9,870,000	9,870,000
Original issue discount**	<u>(7,566,000)</u>	<u>(7,566,000)</u>
	\$1,039,172,000	\$998,672,000
<i><u>Proposed Authority Debt</u></i>		
Sutter Health, Series 2007 (Proposed)		<u>958,000,000</u>
Total Debt	<u>\$1,631,775,000</u>	<u>\$2,407,822,000</u>

*Includes current portion.

**Original issue discount amounts, totaling \$7.6 million, are applicable to various bond issuances above.

VI. DUE DILIGENCE:

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

- Section 1548.5 of the Act (Savings Pass Through): Sutter has provided a description of its savings pass through in Exhibit A
- Section 15491.1 of the Act (Community Service Requirement): Sutter has executed this certification and indicated that Medi-Cal and Medicare patients are accepted. A copy of the certification is provided as Exhibit B.
- Compliance with Seismic Regulations: Sutter has provided a description of its seismic requirements. See Exhibit C.
- Compliance with Assembly Bill 1341: Sutter has provided the necessary documents to show compliance with AB 1341.
- Religious Due Diligence.
- Legal Review.

VII. STAFF RECOMMENDATION:

Staff recommends the Authority approve a Resolution in an amount not to exceed \$958,000,000 for Sutter Health subject to a bond rating of at least an “A” category rating by a nationally recognized rating agency.