

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY (CHFFA)

BOND FINANCING PROGRAM

EXECUTIVE SUMMARY

Applicant: Children’s Hospital of Orange County (“CHOC”) Orange, California Orange County	Amount Requested: \$170,000,000 Date Requested: May 28, 2009 Requested Loan Term: 35 years Resolution Number: 341
Project Sites: 455 South Main Street, Orange, California, Orange County	
Facility Types: Acute Care Hospital/Children’s Hospital	
Obligated Group: CHOC & CHOCO Realty Corporation	

Background: CHOC, headquartered in Orange, California, is a nonprofit organization whose mission is to nurture, advance and protect the health and well-being of children. CHOC’s hospital facility is a regional tertiary referral center and is the largest single provider of pediatric hospital services in Orange County.

Use of Proceeds: Bond proceeds will be used, along with others funds, to finance the construction of a new seven-story patient tower on the hospital’s campus. Additionally, bond proceeds will finance the purchase of new equipment, costs of issuance and a debt service reserve fund (if required). CHOC intends to use a combination of bond proceeds, borrower’s funds, donations and grant funds from Proposition 61 and Proposition 3 for the proposed project (note, these grant fund requests are also on this month’s agenda, along with pertinent staff reports and resolutions).

Type of Issue:	Negotiated public offering with fixed and/or variable rate bonds
Credit Enhancement:	U.S. Bank Letter of Credit on a portion of the bonds
Expected Credit Rating:	A+/A+ S&P/Fitch U.S. Bank rating on Variable Rate Demand Obligation Series
Senior Underwriter:	Morgan Stanley
Bond Counsel:	Orrick, Herrington & Sutcliffe LLP

Financial Overview: The Obligated Group’s income statement appears to demonstrate increased revenues over the last three fiscal years. Additionally, the Obligated Group appears to exhibit a strong balance sheet with adequate liquidity.

<u>Estimated Sources of Funds:</u>		<u>Estimated Uses of Funds:</u>	
Par amount of Bonds	\$145,000,000	Construction	\$428,582,334
Future Debt Issuance	120,000,000	Equipment	52,796,460
Proposition 3 Grant	98,000,000	Debt Service Reserve Fund	16,500,000
Borrower’s Funds	63,883,921	Financing costs	<u>2,500,000</u>
Donations	42,410,000	Total Uses	<u>\$500,378,794</u>
Proposition 61 Grant	<u>31,084,873</u>		
Total Sources	<u>\$500,378,794</u>		

Legal Review: Staff has reviewed the applicant’s responses to the questions contained in the Legal Status portion of the application. The disclosed information 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 \$170,000,000 for Children’s Hospital of Orange County, subject to a bond rating of at least an “A” category rating by a nationally recognized rating agency.

**STAFF SUMMARY AND RECOMMENDATION
Children’s Hospital of Orange County (“CHOC”)**

May 28, 2009

Resolution Number: 341

I. PURPOSE OF FINANCING:

CHOC seeks to invest approximately \$500 million to construct a new seven-story patient tower on the hospital’s campus. Bond proceeds, along with other funds, will be used for construction, costs of issuance and a debt service reserve fund (if required). .

It is anticipated CHOC will fund the project using bond financing of approximately \$145 million. CHOC will use a combination of funds from the Children’s Hospital Program of 2004 (Proposition 61 Grant) and 2008 (Proposition 3 Grant) of approximately \$129 million. As noted on the cover sheet to this report, CHOC has submitted two separate grant requests, both of which are on this month’s agenda for consideration by the Board. The remainder of approximately \$200 million, will be funded with a combination of borrower’s funds, donations and/or future tax-exempt debt.

***Construction*..... \$428,582,334**

The New Tower project will be a free standing seven-story building with a lower level encompassing approximately 425,000 square feet and will be located at the existing campus adjacent and south of CHOC’s North Tower building. The New Tower will initially increase the bed capacity to 266 and allow for future growth (through the build out of shelled space) to approximately 400 beds by 2020. The New Tower will also allow CHOC to open its own emergency room, surgical services, radiological imaging services, and laboratory services which have previously been provided under a service agreement with St. Joseph Hospital of Orange. The construction is anticipated to begin in spring 2009 and to be completed in the fall 2012.

CHOC has an existing Resolution Number 344 for \$130 million approved by the Authority on August 28, 2008. Bond proceeds authorized by Resolution Number 344 will be used to refund previously issued auction rate securities insured by MBIA.

***Equipment*52,796,460**

Additionally, CHOC intends to purchase a variety of medical equipment for the New Tower for various department throughout the newly constructed facility.

***Debt Service Reserve Fund*.....16,500,000**

***Financing Costs*2,500,000**

Cost of Issuance\$1,750,000

Underwriter’s Expense750,000

***Total Uses of Funds* \$500,378,794**

II. FINANCIAL STATEMENTS AND ANALYSIS:

Children's Hospital of Orange County - Obligated Group Statement of Activities (In thousands)

	As of June 30		
	2008	2007	2006
Operating Revenue:			
Net patient service Revenue	\$ 310,793	\$ 270,465	\$ 255,303
Premium revenue	21,704	29,884	45,568
Contribution revenue	-	-	31
Other revenue	46,057	43,569	32,371
Net assets released from restriction used for operations	2,876	2,510	2,684
Total operating revenue	381,430	346,428	335,957
Expenses:			
Salaries and benefits	164,938	139,665	124,758
Purchased services	108,057	111,016	118,357
Supplies	45,496	36,603	35,359
Provision for uncollectible accounts	15,022	12,151	10,543
Rent	5,528	5,206	5,060
Depreciation & amortization	17,295	13,770	12,326
Interest Expense	3,558	2,154	1,521
Other	13,182	12,476	11,930
Total operating expenses	373,076	333,041	319,854
Income (loss) from operations before other gains (losses)	8,354	13,387	16,103
Other gains (losses):			
Gains (loss) on sale of property	-	(122)	(88)
Interest and other income (loss)	3,644	4,965	3,749
Contributions from CHOC Foundation	195	-	-
Other gains:	3,839	4,843	3,661
Revenue and gains in excess of expenses and losses	12,193	18,230	19,764
Change in value of split-interest agreements	-	164	(123)
Unrealized loss on derivative financial instrument	7,183	2,858	9,136
Net assets released from restriction used for capital equipment	(15,135)	10,318	3,371
Donated capital equipment and grant funds received for capital expansion	-	-	896
Increase unrestricted net assets	4,241	31,570	33,044
Unrestricted net assets, beginning of the period	218,017	162,554	128,336
Unrestricted net assets, end of period	\$ 226,636	\$ 218,017	\$ 162,554

Children's Hospital of Orange County - Obligated Group

Statement of Financial Position

(In thousands)

	As of June 30		
	2008	2007	2006
Assets:			
Current assets:			
Cash and cash equivalents	\$ 32,600	\$ 57,569	\$ 54,039
Short-term investments	25,853	5,373	4,798
Assets whose use is limited	1,543	3,013	4,238
Patient account receivables, net	76,489	67,366	59,860
Inventory	2,553	2,509	2,138
Other receivables	9,740	10,433	9,381
Receivables from related parties	2,099	2,357	2,687
Pledges receivable - current	-	731	310
Current portion of beneficial interest net assets of CHOC Foundation	2,833	-	-
Prepaid expenses	5,352	5,895	4,558
Total current assets	<u>159,062</u>	<u>155,246</u>	<u>142,009</u>
Assets whose use is limited			
Designated by board	2,390	2,444	1,727
Funds held by trustee	-	21,743	-
Restructured by donors	-	-	47,900
Other	681	-	-
	<u>3,071</u>	<u>24,187</u>	<u>49,627</u>
Property and Equipment	243,753	212,821	147,659
Beneficial interest in net assets of the Foundation	5,191	-	-
Pledges receivable	-	1,560	646
Receivable from related parties	-	1,615	1,468
Bond issuance cost, net	2,998	3,165	3,327
Derivative financial instruments	39	7,621	4,439
Covenant not to compete, net	-	-	113
Other assets	2,666	2,522	2,059
Total assets	<u>416,780</u>	<u>408,737</u>	<u>351,347</u>
Liabilities and Net Assets:			
Current liabilities:			
Current portion of long-term debt	\$ 2,489	\$ 2,327	\$ 2,315
Accounts payable accrued liabilities	32,777	42,148	31,446
Accrued compensation and related liabilities	21,509	17,999	15,145
Medical claims payable	1,506	1,658	7,099
Deferred income	1,097	2,305	3,950
Payable third party payers	-	305	-
Payable to contracting hospitals	1,102	1,089	3,507
Payable to related parties	577	138	41
Total current liabilities	<u>61,057</u>	<u>67,969</u>	<u>63,503</u>
Long-term debt and capital lease	107,866	110,356	112,683
Estimated liability for workers comp, net of current portion	8,303	6,903	7,080
Post retirement benefit obligations	3,538	3,911	-
Derivative financial instruments	7,838	-	4,404
Other liabilities	1,542	1,581	1,123
Total liabilities	<u>190,144</u>	<u>190,720</u>	<u>188,793</u>

Children's Hospital of Orange County - Obligated Group (Continued)
Statement of Financial Position
(In thousands)

	As of June 30		
	2008	2007	2006
Unrestricted net assets			
Undesignated	202,511	200,500	150,066
Board designated	2,390	1,763	1,727
Total unrestricted	204,901	202,263	151,793
Temporarily restricted	21,049	15,068	10,069
Permanently restricted	686	686	692
Total net assets	226,636	218,017	162,554
 Total liabilities and assets	 \$ 416,780	 \$ 408,737	 \$ 351,347

Financial Ratios:

	Proforma (a)			
	<u>FYE June 30, 2008</u>			
Debt Service Coverage (x)	2.73	5.46	7.62	8.76
Debt/Unrestricted Net Assets (x)	1.37	0.54	0.56	0.76
Operating Margin (%)		2.19	3.86	4.79
Current Ratio (%)		2.61	2.28	2.24

(a) Recalculates 2008 audited results to include the impact of this proposed financing.

Financial Discussion:

The Obligated Group's income statement appears to demonstrate increased revenues over the last three fiscal years.

Total operating revenue has increased an average of approximately 7% per year over the last three fiscal years from approximately \$336 million in fiscal year 2006 to \$381 million in fiscal year 2008. This is primarily a result of increased utilization for inpatient and outpatient services. Patient days have risen on average approximately 4% per year while outpatient visits increased 7% per year in fiscal year 2006 through fiscal year 2008. Net patient service revenue also increased substantially from \$255 million in fiscal year 2006 to \$311 million in fiscal year 2008 as a result of the addition of Intensive Care beds added during fiscal year 2008 (Pediatric, Cardiovascular and Neonatal), increased utilization of higher acuity services, strong health plan negotiations, increased market share related to partnerships and affiliations effectuated in 2008.

During the review period, total expenses have increased an average of approximately 8%, keeping in line with the growth in revenues. Due to the opening of new units and the growth in volume and complexity of services, CHOC's salaries and benefits increased on a cost per adjusted patient day basis by an increase of 6% in fiscal year 2008 and an increase of 11% in fiscal year 2007. Additionally, management believes a competitive salary enhances CHOC's work environment with high morale and low employee turnover. Interest expense increased approximately \$1.4 million as a result of the disruptions in the global auction rate securities market in fiscal year 2008, resulting in failed auctions, causing the interest rate on the outstanding bonds to be determined by formula rather than by auction.

The Obligated Group appears to exhibit a strong balance sheet with adequate liquidity.

The Obligated Group's balance sheet appears to continue growing with total net assets increasing from \$218 million in fiscal year 2007 to \$227 million in fiscal year 2008, an increase of 4%. The primary change was related to various construction projects which increased property, plant and equipment by approximately \$31 million funded by cash and cash equivalents, offset primarily by a \$21 million decrease in assets whose use is limited. The Obligated Group experienced an increase in unrestricted net assets from \$202 million in fiscal year 2007 to \$205 million in fiscal year 2008. Patient accounts receivables increased from \$67 million in fiscal year 2007 to \$76 million in fiscal year 2008 as a result of the higher volumes and utilization.. The debt service coverage ratio is a solid 5.46x and with the proposed financing, the proforma debt service coverage ratio appears to remain solid at 2.73x, indicating the Obligated Group can likely manage additional debt.

III. BACKGROUND:

CHOC was incorporated and began operating in 1964. CHOC's original 62-bed facility was located in a leased wing of St. Joseph Hospital of Orange, with which CHOC shared hospital services, such as surgery, laboratory, radiology, among others. With a growth in demand, in 1975 CHOC moved to a former skilled nursing facility renovated into an acute care pediatric hospital, including neonatal and pediatric intensive care units and increased licensed capacity to 190 beds. CHOCO Realty Corporation ("Realty"), which holds title to all of CHOC's land and buildings, purchased a two-story building adjacent to CHOC's acute care pediatric hospital and renovated the building to house ambulatory care services, including an outpatient clinic and outpatient pharmacy, psychology services, medical records, computer services, pediatric subspecialty medical offices and several administrative departments. In 1990, Realty constructed a six-story research building and an expanded clinic facility adjacent to CHOC's acute care pediatric hospital, and, in 1991, Realty constructed a 192 licensed bed replacement facility for all inpatient services ("CHOC North"). During the summer of 2002, because of increased demand, CHOC added 10 new intensive care beds. This brought the current Newborn Intensive Care ("NICU") unit bed complement to 42, and CHOC's total beds to 202.

Due to the continued increase in demand, in the fall of 2007, CHOC built out the sixth floor of CHOC North in previously shelled-in space, adding 18 Pediatric Intensive Care ("PICU") and 12 Cardiovascular Intensive Care ("CVICU") beds. The relocation of the PICU unit to the sixth floor of CHOC North allowed for 12 additional NICU beds to be added in space previously occupied by PICU beds. This expansion brought the NICU to its current complement of 54 beds, the PICU to its current complement of 30 beds, and CHOC's total licensed beds to 232. This summer, 6 adolescent oncology beds will be added which increase CHOC's total licensed beds to 238.

Corporate Structure

In 1986, Children's HealthCare of California ("CHC") was incorporated as the "parent" company and sole corporate member of CHOC and of Realty, as well as three affiliated California nonprofit public benefit corporations (collectively, the "Affiliates"). CHC has no operations. Its main functions are as the holder of investment securities for itself and its Affiliates and as the director of strategy for the Affiliates. CHOC and Realty are the only "Members" of the "Obligated Group."

Licenses and Contracts

CHOC is appropriately licensed by the Department of Public Health Services and is certified to participate in the Medicare and Medi-Cal programs.

Other Affiliates of CHC

CHOC Foundation was formed in 1964 to help support clinical and non-clinical medical education, research and allied fields of pediatric care exclusively at CHOC.

Children's Hospital at Mission ("CHOC at Mission") was formed in 1991 and operates a 48-bed acute pediatric hospital located in Mission Viejo, California. CHOC at Mission is a "hospital within a hospital," located on the fifth floor of the adult Mission Hospital, a member of the St. Joseph Health System. CHOC at Mission provides nursing services and purchases its ancillary services from Mission Hospital through an operating agreement between CHOC at Mission and Mission Hospital.

CRC Real Estate Corporation ("CRC") is a California nonprofit public benefit corporation originally formed in 1993 as a for-profit corporation to acquire a 173,000-square-foot commercial office building. The original office building was sold in October 2004, and in March 2004, CRC acquired a 12-story office building across the street from CHOC North. The majority of the building has been leased to commercial tenants, and the remainder of the building is used for certain hospital administrative and medical functions.

Governance

CHOC is governed by a 14-member Board of Directors. CHOC's Bylaws provide that the Board of Directors will consist of four representatives of the University of California, Irvine ("University Directors"), the President of CHOC, and nine members who can contribute meaningfully to the governance of CHOC due to their background and experience.

Realty is governed by a five-member Board of Directors, which includes the President of CHOC. Nominations to the Board of Directors are made by the sitting members of the Realty Board of Directors. The number of terms a Director may serve is unlimited.

CHC is governed by a 10-member Board of Directors. The Bylaws of CHC provide that the CHC Board of Directors consists of the President of CHOC, three University Directors of CHC and six other persons who are Directors of certain affiliates of CHC.

IV. UTILIZATION STATISTICS:

The following table presents selected summary utilization statistics for CHOC for the three fiscal years ended June 30, 2006, 2007 and 2008.

	Year Ended June 30,		
	2006	2007	2008
Number of Licensed Beds	202	202	232
Discharges	10,405	10,331	10,601
Patient Days	55,667	54,336	60,279
Average Length of Stay	5.3	5.3	5.7
Occupancy Based on Licensed Beds	75.5	73.7	71.0
Outpatient Visits:			
Emergency Room Visits	43,703	44,307	50,059
Specialty Clinic Visits	54,196	58,050	61,982
Primary Care Outreach Clinic Visits	75,533	76,921	84,545
Outpatient Surgery	4,179	4,526	4,739
Outpatient Infusion Center Visits	-	-	486
Outpatient Observation	1,871	1,969	1,807
Total Outpatient Visits	179,482	185,773	203,618

V. OUTSTANDING DEBT:

As of fiscal year ending June 30, 2008, the Obligated Group had approximately \$110 million in outstanding long-term debt all of which is Authority debt. With this bond financing, the Obligated Group's outstanding debt will increase approximately \$170 million for a total of \$280 million in outstanding long-term debt.

VI. DUE DILIGENCE:

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

- **Section 15438.5(a) of the Act (Savings Pass Through):** CHOC properly completed and submitted the "Pass-Through Savings Certification," in addition to a narrative explaining how it intends to pass through savings.
- **Section 15491.1 of the Act (Community Service Requirement):** CHOC properly completed and submitted this certification and indicated that Medi-Cal and Medicare patients are accepted.
- **Compliance with Seismic Regulations:** CHOC properly completed and submitted a description of its seismic requirements.
- **Compliance with Section 15455(b) of the Act (California Environmental Quality Act):** CHOC properly submitted documentation to the Authority demonstrating the proposed project has either complied with Division 13 (commencing with Section 21000) of the Public Resources Code, or is otherwise not a project under that division.
- **Religious Due Diligence.**
- **Legal Review.**