

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY (CHFFA)

BOND FINANCING PROGRAM

EXECUTIVE SUMMARY

Applicant: Providence Health System Southern California Seattle, Washington (headquarters)	Amount Requested: \$150,000,000 Date Requested: June 25, 2009 Requested Loan Term: 30 years Resolution Number: 342
Obligated Group: Providence Health & Services (“Providence”) Project Site: Providence Holy Cross Medical Center 15031 Rinaldi, Mission Hills, California, Santa Barbara County Facility Type: General acute/sub acute and outpatient care	
Background: Providence is a nonprofit health system providing health care services in the States of Washington, Oregon, Montana, Alaska and California.	
Use of Proceeds: Bond proceeds will be used to construct a four-story medical tower, to complete required seismic retrofits, and to upgrade an existing central utility plant.	
Type of Issue: Negotiated public offering with fixed rate securities Credit Enhancement: None Expected Credit Rating: Aa2/AA/AA Moody’s/S&P/Fitch Senior Underwriter: Merrill Lynch & Co. Bond Counsel: Sidley Austin LLP	
Financial Overview: Providence’s income statement appears to exhibit solid operating results with positive operating income over the review period, along with continued revenue growth. Providence’s financial strength appears to be sound with good liquidity and significant financial resources.	
<u>Estimated Sources of Funds (000’s):</u> Par amount of bonds \$150,000 Original Issue Discount (4,311) Total Sources <u>\$145,689</u>	<u>Estimated Uses of Funds (000’s):</u> Project \$126,689 Capitalized Interest 16,000 Financing Costs <u>3,000</u> Total Uses <u>\$145,689</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 \$150,000,000 for Providence Health & Services subject to a bond rating of at least an “A” category rating by a nationally recognized rating agency.	

STAFF SUMMARY AND RECOMMENDATION

Providence Health & Services

June 25, 2009

Resolution Number: 342

I. POLICY ISSUES:

The Authority adopted bond issuance guidelines in September 2000 which includes a gross revenue pledge as a security provision and a minimum debt service coverage of 1.25x. The Authority acknowledged each financing must be reviewed individually and exceptions to these guidelines may be considered if the applicant demonstrates that such exception is a necessary part of a cost-effective and prudent borrowing strategy. Providence management and bond counsel state that existing master indenture covenants preclude Providence from providing a gross revenue pledge and from providing a minimum debt service coverage ratio of 1.25x. Rather, Providence’s master indenture imposes a minimum 1.10x debt service coverage ratio. Additionally, in light of recent market tumult, Providence desires a minimum debt service coverage ratio of 1.10x to afford Providence maximum flexibility in a potentially chaotic marketplace. In consideration of the historical and current financial strength of Providence (its current proforma debt service coverage is a healthy 6.21x, based strictly on operating results¹) and the extraordinary market conditions over the last year, staff recommends waiving the gross revenue pledge requirement and additionally, allowing Providence to adhere to a minimum debt service coverage ratio of 1.10x. The Authority board has previously authorized Providence to adhere to this lower debt service coverage ratio of 1.10x and the Authority has also previously waived the gross revenue pledge requirement, as recent as September of 2008.

II. PURPOSE OF FINANCING: Providence intends to use bond proceeds for a major expansion of Providence Holy Cross Medical Center located in Mission Hills, California. It is anticipated that the expansion will relieve current overcrowding by increasing the number of licensed beds from 206 to 342. Additional bond proceeds will be used for seismic retrofitting and upgrades to the existing central utility plant.

Project \$126,689,000

Providence intends to construct a 120,000 square foot, four-story tower, 136-bed medical tower. The new tower project is an expansion of an existing three-story acute care facility at Providence Holy Cross Medical Center. Construction began in 2008 and is expected to be complete in February 2011.

In addition, Providence seeks to use approximately \$60 million in bond proceeds to reimburse itself for amounts expended in 2008 in preparation for the construction of the tower.

¹ As a result of realized and unrealized losses in fiscal year 2008 Providence’s proforma debt service coverage ratio is a negative 3.33x. However, based solely on operation results, the operating proforma debt service coverage ratio is a solid 6.21x indicating the negative debt service coverage ratio will unlikely impact the repayment of bonds and that Providence has adequate revenue streams to support the new debt.

<i>Capitalized Interest</i>	16,000,000
<i>Financing Costs</i>	3,000,000
<i>Cost of issuance</i>	\$1,000,000
<i>Underwriters expense</i>	2,000,000
<i>Total Uses of Funds</i>	<u>\$145,689,000</u>

III. FINANCIAL STATEMENTS AND ANALYSIS:

Providence Health & Services
Consolidated Income Statement of Operations (\$000's)

	For the year ended December 31,		
	2008	2007	2006
<u>Operating Revenue</u>			
Net patient service revenue	\$ 5,653,268	\$ 5,092,729	\$ 4,637,229
Premium revenue	1,016,421	912,904	854,120
Other revenues	356,452	342,404	329,944
Total revenues	<u>7,026,141</u>	<u>6,348,037</u>	<u>5,821,293</u>
<u>Operating Expenses</u>			
Salaries and wages	2,679,885	2,413,085	2,232,082
Employee benefits	745,630	621,115	594,909
Purchased healthcare	610,791	539,351	492,461
Professional fees	204,517	186,276	169,355
Supplies	965,503	869,909	816,892
Depreciation	333,008	292,368	262,805
Interest and amortization	63,521	62,884	52,160
Bad debts	216,717	226,578	174,201
Provider tax	8,804	10,664	8,649
Purchased services and other	909,803	820,646	750,359
Total operating expenses	<u>6,738,179</u>	<u>6,042,876</u>	<u>5,553,873</u>
Excess of revenues over expenses	287,962	305,161	267,420
<u>Other Income</u>			
Net nonoperating gains (losses), investment	(444,664)	349,421	189,723
(Deficit) excess of revenues over expenses	(156,702)	654,582	457,143
Net assets released from restriction and other	10,871	21,566	18,540
Change in accrued additional minimum pension	(591,843)	25,925	52,493
Implementation of SF AS 158	(26,100)	(96,304)	-
Change in net unrealized gains (losses)	-	42,856	10,708
Reclassification of investment portfolio	-	(214,387)	-
Discontinued operations-Benefits Healthcare	-	-	(190,521)
(Decrease) increase in unrestricted net assets	(763,774)	434,238	348,363
Unrestricted net assets, beginning of year	4,446,971	4,012,733	3,664,370
Unrestricted net assets, end of year	<u>\$ 3,683,197</u>	<u>\$ 4,446,971</u>	<u>\$ 4,012,733</u>

Providence Health & Services
Consolidated Balance Sheets (in \$000's)

	December 31,		
	2008	2007	2006
<u>Assets</u>			
Current assets:			
Cash and cash equivalents	\$ 491,812	\$ 359,390	\$ 410,937
Short-term board designated investments	223,083	-	-
Assets held under securities lending	204,524	257,001	159,169
Accounts receivable less allowance for bad debt	813,723	751,915	714,824
Other receivables, net	150,994	126,981	117,262
Supplies inventory	111,358	87,092	80,297
Other current assets	59,538	51,595	53,474
Current portion of assets whose use is limited	81,476	71,403	67,619
Total current assets	<u>2,136,508</u>	<u>1,705,377</u>	<u>1,603,582</u>
Assets whose use is limited:			
Board-designated cash and investments	1,736,404	2,189,463	2,115,003
Gift annuities and trusts	37,061	52,864	69,244
Funds held by trustee	122,780	346,299	322,731
Assets who use is limited, net of current portion	<u>1,896,245</u>	<u>2,588,626</u>	<u>2,506,978</u>
Property, plant and equipment, net	3,666,673	3,289,435	2,929,823
Other assets	214,960	189,480	223,253
Total assets	<u>\$ 7,914,386</u>	<u>\$ 7,772,918</u>	<u>\$ 7,263,636</u>
<u>Liabilities & Net Assets</u>			
Current liabilities:			
Current portion of long-term debt	\$ 33,664	\$ 33,240	\$ 36,769
Master trust debt reclassified as short-term	553,997	-	-
Short-term debt	20,000	-	-
Accounts payable	292,449	276,523	275,762
Accrued compensation	304,383	256,314	246,300
Payable to contractual agencies	77,325	79,977	91,756
Unearned premiums/deferred revenue	32,756	31,686	30,384
Liability for unpaid medical claims	53,265	41,511	42,153
Liability for risk-sharing	15,263	13,826	18,056
Liabilities under securities lending	218,233	257,001	159,169
Current portion of self-insurance liability	79,949	68,934	64,667
Other, including accrued interest	45,272	52,123	48,120
Total Current Liabilities	<u>1,726,556</u>	<u>1,111,135</u>	<u>1,013,136</u>
Long term debt, net of current portion	1,148,619	1,484,974	1,559,559
Other long-term liabilities:			
Self-insurance liability, net of current portion	199,114	194,478	187,719
Pension benefit obligation	845,861	225,956	171,111
Gift annuity obligations and trust	16,605	17,173	16,640
Other liabilities	66,676	66,644	89,593
Total other long-term liabilities	<u>1,128,256</u>	<u>504,251</u>	<u>465,063</u>
Total liabilities	<u>4,003,431</u>	<u>3,100,360</u>	<u>3,037,758</u>
Net assets:			
Unrestricted	3,683,197	4,446,971	4,012,733
Temporarily restricted	173,234	170,957	162,460
Permanently restricted	54,524	54,630	50,685
Total Net Assets	<u>3,910,955</u>	<u>4,672,558</u>	<u>4,225,878</u>
Total Liabilities & Net Assets	<u>\$ 7,914,386</u>	<u>\$ 7,772,918</u>	<u>\$ 7,263,636</u>

Financial Ratios:

	Proforma (a)				
	FYE December 31, 2008				
Debt Service Coverage (x)	(3.33)	(b)	(3.78)	8.21	7.46
Debt/Unrestricted Net Assets (x)	0.36		0.32	0.34	0.40
Margin (%)			4.10	4.81	4.59
Current Ratio (x)			1.24	1.53	1.58

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

(b) Using 2008 operating results amounts to a debt service coverage ratio of 6.21x.

Financial Discussion:

Providence's income statement appears to exhibit solid operating results with positive operating income over the review period along with continued revenue growth.

Providence's income statement appears to exhibit solid profitability over our review period with operating income remaining steady from \$267 million in fiscal year 2006 to \$288 million in fiscal year 2008. In addition, Providence appears to have shown solid operating margins of 4.59%, 4.81% and 4.10% for fiscal years 2006, 2007 and 2008 respectively. Providence's revenues consist primarily of net patient service revenue accounting for approximately 80% of total revenues in fiscal year ending 2008. Total revenue increased from \$5.8 billion in fiscal year 2006 to \$7.0 billion in fiscal year 2008, an increase of 20%. Providence attributes the increase to focused efforts on eliminating waste through improved productivity, reduction in supply expenses, standardization of processing, and optimal use of shared administrative services.

Providence experienced a net non-operating loss of \$444 million in fiscal year 2008. Unrealized investment losses of \$470 million contributed to a net loss for fiscal year 2008 of \$156 million compared to a \$654 million gain in fiscal year 2007. Providence has adopted a more conservative asset allocation target with a goal to improve its liquidity in the future.

Providence's financial strength appears to be sound with good liquidity and significant financial resources.

Net assets have grown 10% over the review period, from \$7.3 billion in fiscal year 2006 to \$7.9 billion in fiscal year 2008. Contributing to this growth were increases in cash and cash equivalents stemming from investment returns, cost savings as well as solid operating results. Net property, plant and equipment increased by 23% from \$3.6 billion in fiscal year 2006 to \$3.2 billion in fiscal year 2008 reflecting a substantial investment in technology and hospital renovations.

With an unrestricted net assets balance exceeding \$3.6 billion in fiscal year 2008, the proforma debt to unrestricted net assets is a low 0.36x. Although the proforma debt service coverage ratio is a negative 3.33x, this is directly related to the realized and unrealized investments losses. Based strictly on operational results, the proforma operating debt service coverage ratio appears be a solid 6.21x, indicating Providence can likely support additional debt.

IV. BACKGROUND:

Providence is a not-for-profit health system committed to providing a comprehensive array of services to meet the needs of communities across five states, including Alaska, Washington, Montana, Oregon and California. Providence continues the legacy of the Sisters of Providence and the Sisters of the Little Company of Mary in the West spanning more than 150 years.

Providence includes 26 hospitals, more than 35 non-acute facilities, physician clinics, a health plan, a liberal arts university, a high school, approximately 45,000 employees and numerous other health, housing and educational services. Its headquarters are located in Seattle, Washington.

Providence Health & Services in Alaska, Washington, Montana and Oregon is sponsored by the Sisters of Providence religious community. In Southern California, the health ministry is co-sponsored by the Sisters of Providence and the Little Company of Mary. Corporate Members of Providence Health & Services in Alaska, Washington, Montana and Oregon, with specified reserved canonical powers, are members of the Leadership Team of the Sisters of Providence, Mother Joseph Province. Corporate members of Providence Health System – Southern California are members of the Leadership Teams of both Sisters of Providence and Sisters of the Little Company of Mary.

Licenses and Contracts: Each of Providence’s California facilities is appropriately licensed by the Department of Health Services and is certified to participate in the Medicare and Medi-Cal programs.

V. UTILIZATION STATISTICS:

Providence Health & Services

California Hospitals Only

<u>Facility Name</u>	<u>Location</u>	<u># of Licensed Acute Care Beds</u>	<u># of Licensed Long-term Care Beds</u>
Providence St. Joseph Medical Center	Burbank	360	71
Providence Holy Cross Medical Center	Mission Hills	206	48
Providence Tarzana Medical Center	Tarzana	245	-
Providence Little Company of Mary Medical Center Torrance	Torrance	321	-
Providence St. Elizabeth Care Center	North Hollywood	-	52
Providence Little Company of Mary Pavilion Torrance*	Torrance	115	-
Providence Little Company of Mary Sub-Acute Care Center	San Pedro	-	200
Providence Little Company of Mary Medical Center San Pedro	San Pedro	183	-
Providence Little Company of Mary Pavilion San Pedro	San Pedro	-	125
Providence Little Company of Mary Recovery Center	San Pedro	-	48

* Two facilities.

VI. OUTSTANDING DEBT:

As of fiscal year ending December 31, 2008, Providence has approximately \$1.15 billion in outstanding long-term debt, of which \$304 million is Authority debt. With this bond financing, Providence's outstanding debt will increase \$150 million for a total of approximately \$1.30 billion in outstanding long-term debt.

VII. DUE DILIGENCE:

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

- **Section 15438.5(a) of the Act (Savings Pass Through):** Providence 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):** Providence properly completed and submitted this certification and indicated that Medi-Cal and Medicare patients are accepted.
- **Compliance with Seismic Regulations:** Providence properly completed and submitted a description of its seismic requirements.
- **Compliance with Section 15455(b) of the Act (California Environmental Quality Act):** Providence 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.**