CHFFA HELP II LOAN PROGRAM
EXECUTIVE SUMMARY

Applicant:	Encompass Community Services ("ECS") 380 Encinal Street, Suite 200 Santa Cruz, CA 95060 Santa Cruz County	**Amount Requested:** **Requested Loan Term:** **Authority Meeting Date:** **Resolution Number:**	$1,000,000 20-year fixed April 26, 2018 HII-312

Project Site: 161 Miles Lane, Watsonville, CA 95076
Facility Type: Alcoholism Recovery and Substance Use Disorder Treatment Facility
Eligibility: Government Code section 15432(d)(14)
Prior HELP II Borrower: No

Background: ECS is a licensed nonprofit organization with over 30 distinct programs county-wide providing services in substance use disorder ("SUD") treatment, behavioral health, family and social well-being, early childhood education, housing, and more. It is the largest community-based nonprofit in Santa Cruz county. ECS' mission is to build on the strength of people working together to create health change in their lives and in its community. The four primary types of programs that ECS provides are child and family development, integrated behavioral health, community-based support, and unified support.

Use of Loan Proceeds: Loan proceeds will be used to finance the purchase of property and construction. The loan will allow ECS to leverage a $2.5 million grant, which will provide the majority of funding for its project. ECS will be able expand its substance use disorder program, Si Se Puede, and provide a continuum of care in partnership with MidPen Housing ("MidPen").

Financing Structure:

- First lien on real property located at 161 Miles Lane, Watsonville, CA 95076
- 20-year, two percent (2%) fixed rate loan
- 240 equal monthly payments of approximately $5,059 (annual payments of approximately $60,706)
- A current appraisal that is acceptable to the Authority staff
- Corporate gross revenue pledge
- Loan to value ratio not to exceed 95% (estimated loan to value ratio is approximately 35%)
- Verification of Borrower's funds prior to closing
- Executed construction contract
- Verification of receipt of other funding sources acceptable to Authority staff
- Establishment of a debt service reserve fund
- Provision of unaudited quarterly financial statements
- Authority site visits

Financial Overview: ECS has developed a three-year financial plan to recover and stabilize its revenues and expenses. It has agreed to additional security on the loan to offset its negative debt service coverage ratio.

Estimated Sources of Funds:		**Estimated Uses of Funds:**	
HELP II loan	$ 1,000,000	Construction	$ 3,435,500
Central CA Alliance for Health Grant	2,500,000	Purchase real property	448,000
Monterey Peninsula Foundation Grant	400,000	Furnishing and equipment	350,000
Borrower's funds	300,000	Financing costs	14,500
Other (major gifts, grants)	48,000		
Total Estimated Sources	$ 4,248,000	**Total Estimated Uses**	$ 4,248,000

Due Diligence: Staff has received and reviewed the Eligibility, Legal Review, Religious Due Diligence, Savings Pass Through and Community Service Requirement documentation. All documentation satisfies the Authority's requirements.

Parties of Interest: Michael Marshisio; Old Republic Title Company; MidPen Housing

Staff Recommendation: Staff recommends approval of Resolution Number HII-312 for Encompass Community Services in an amount not to exceed $1,000,000 for a term not to exceed 20 years, and contingent upon financing terms acceptable to the Authority. Macias Gini & O'Connell LLP, the Authority's financial analyst, concur with the Authority's staff recommendation.

(CW)

I. ISSUES:

For FYs 2016 and 2017, ECS displayed debt service coverage ratios of (-25.69x) and (-13.46x), respectively, and a FY 2017 pro forma ratio of (-4.94x). CHFFA has historically upheld a debt service coverage ratio minimum of 1.1x for HELP II loans. In order to mitigate some of the risk associated with negative debt service coverage ratios, ECS has agreed to three additional security features on the loan. First, ECS has agreed to establish a debt service reserve fund of approximately $120,000 (two years of loan payments) until the new center opens at the beginning of 2020. Once the center opens, one year of loan payments of approximately $60,000 would remain in the reserve fund until ECS improves their debt service coverage ratio to 1.1x for three consecutive fiscal years. Second, ECS has agreed to submit to CHFFA quarterly unaudited financial statements for staff review until ECS could display a debt service coverage ratio of 1.1x for three consecutive fiscal years. Third, it has agreed to Authority site visits, at any date of the Authority's request.

II. PURPOSE OF FINANCING:

ECS is seeking a $1 million HELP II loan to acquire land and construct a SUD treatment facility to replace its existing facility for its Si Se Puede program. Loan funds will leverage a $2.5 million grant from the Central California Alliance for Heath Group. The grant will finance a majority of ECS' project and is earmarked for ECS, contingent upon securing additional financing equal to 25% of the project, which the HELP II loan would satisfy. ECS expects to receive the grant in June 2018. The new recovery center will expand the number of residential SUD treatment days for Medi-Cal and uninsured populations by 30% per year. The new facility will have capacity for 30 residential treatment beds and provide outpatient treatment and educational services for individuals with more moderate disorders. ECS' project partner, MidPen, will build 40 units of affordable housing via Low-Income Tax Credit financing. ECS' newly constructed Si Se Puede facility, in conjunction with MidPen's proposed 40 units of affordable housing, will be able to provide a continuum of care at a single site.

Construction.. 3,435,500

ECS intends to use loan proceeds along with other sources of funds to build a new 7,500 square foot, two-story facility located at its current Si Se Puede site. It will have capacity for 30 residential treatment beds. There will be space for integrated health services, Medication Assisted Treatment for opioid use disorders, individual/group counseling, classrooms, exercise and recreation, and family visits. The new facility will include a medical exam room for integrated health care services and add capacity to provide Medication Assisted Treatment for opioid use disorders. ECS plans to begin construction January 2019, finishing by November 2019 and opening January 2020. Prevailing wages will be paid for the construction project.

Purchase real property	***$448,000***

ECS will partner with nonprofit housing developer MidPen to purchase three adjacent parcels in Watsonville, CA for a total of $2,240,000. Loan proceeds will be used for ECS' purchase share. ECS will purchase property currently being leased for its Si Se Puede SUD program. Per a Memorandum of Understanding, ECS and MidPen will complete entitlement work together and then develop projects separately, with each owning their respective land and buildings. ECS plans to purchase property by December 2018. HELP II loan funds will not be used by MidPen.

The HELP II loan will be secured by a first (1st) lien position on the property located at 161 Miles Lane, Watsonville, CA 95076. An appraisal will be completed prior to closing to ensure a loan-to-value ratio of less than 95%. ECS' management estimates the value of the property upon completion of construction at $2.89 million, resulting in an estimated loan-to-value ratio of 35%.

Furnishing and Equipment	***350,000***

ECS intends to purchase furniture and equipment to complete the new residential treatment facility and integrated health services spaces, including: new information technology equipment, furnishings and equipment throughout the new facility, and seven staff work stations. HELP II funds will not be used for furnishing and equipment.

Financing Costs		***14,500***
Authority Fees	$12,500	
Estimated Escrow/Title Fees	2,000	
Total Uses of Funds		**$4,248,000**

III. FINANCIAL STATEMENTS AND ANALYSIS:

Encompass Community Services
Statement of Activites
(Unrestricted)

	As of June 30,		
	2017	**2016**	**2015**
Unrestricted Net Assets:			
Support			
Foundations	67,885	70,750	168,490
Donations/Fundraising	144,045	153,502	430,205
United Way	1,320	8,237	36,935
Cost reimbusement contracts	14,877,805	12,800,963	11,645,047
Total Support	15,091,055	13,033,452	12,280,677
Revenue			
Fee for service contracts	10,004,184	10,256,277	10,812,113
Client fees	1,304,820	1,335,777	1,333,714
Contracts	906,505	800,794	818,635
Investment income	3,006	538	1,674
Rents	307,813	384,417	332,234
In-kind	1,280,237	1,098,429	1,467,248
Other	10,519	19,679	21,017
Total Revenue	13,817,084	13,895,911	14,786,635
Total Support and Revenue*	28,908,139	26,929,363	27,067,312
Net Assets Released from Restrictions	98,177	78,113	89,587
Total Unrestricted Support and Revenue	29,006,316	27,007,476	27,156,899
Expenses			
Client and support care	1,457,987	1,203,662	1,089,173
Conference and meetings	58,460	54,649	78,544
Consulting services	232,547	267,615	254,959
Depreciation	141,503	164,734	282,098
Employee Training	254,135	122,294	115,615
Employment agency fees	39,874	40,829	34,397
Equipment rental and maintenance	74,305	75,685	60,475
Fundraising	3,068	5,300	8,708
Homeless loan expense	(4,335)	5,909	4,981

(Continued)

	As of June 30, 2017	2016	2015
Insurance	141,140	136,380	121,126
Interest	38,540	3,921	3,563
Legal and accounting	99,573	42,166	64,946
Medical supplies and exams	100,372	63,077	44,456
Membership dues	28,927	28,335	27,085
Miscellaneous	37,895	32,312	33,498
Payroll outsourcing fee	108,484	101,602	96,123
Postage and delivery	58,585	50,121	63,900
Printing and copying	75,369	54,469	60,610
Publications	16,104	15,872	12,264
Recruitment	51,975	51,034	48,531
Referral fees	44,241	49,800	49,294
Rent	1,708,969	1,626,679	1,539,458
Repairs and maintenance	562,942	398,566	358,648
Salaries and benefits	20,798,160	20,004,085	19,818,096
Small equipment and furniture	270,599	266,181	177,349
Sub contracts	586,615	68,299	60,070
Supplies	471,166	416,755	403,060
Tax and license	23,719	41,882	20,804
Telephone	394,101	323,267	305,870
Travel	228,005	235,273	206,261
Utilities	364,667	344,051	304,712
Vehicle expense	72,321	94,059	68,038
In-kind expense	1,280,237	1,098,429	1,467,248
Total Expenses	29,820,250	27,487,292	27,283,960
Change in Unrestricted Net Assets	(813,934)	(479,816)	(127,061)
TEMPORARILY RESTRICTED NET ASSETS			
Foundations	424,425	80,000	-
Net Assets Released from Restrictions	(98,177)	(78,113)	(89,587)
Change in Temporarily Restricted Net Assets	326,248	1,887	(48,059)
Change in Net Assets	(487,686)	(477,928)	(175,120)
Net Assets Beginning of Year	1,771,074	2,249,002	2,424,122
Net Assets End of Year	$ 1,283,388	$ 1,771,074	$ 2,249,002

***Total support and revenue for FYE June 30,**

Relevant Payor Sources	**2017**	**2016**
Cost Reimbursement Contracts[1]	52.0%	48.3%
Medi-Cal	20.1%	22.2%
Insurance and Other Third Party Payors	14.9%	16.5%
Private Pay Patients/Client Fees	4.6%	5.0%
Other	8.4%	8.0%
Total	**100%**	**100%**

[1] Includes reimbursements from federal, state and county governments for costs to provide program services.

Emcompass Community Services
Statement of Financial Position

	As of June 30, 2017	2016	2015
Assets			
Current assets:			
Cash and equivalents	$ 619,063	$ 909,481	$ 1,044,736
Short-term investments	689,847	825,196	763,656
Grants and accounts receivable	2,536,793	1,989,879	1,700,700
Prepaid expenses	251,129	26,970	206,666
Deposits	120,617	224,407	166,325
Total current assets	4,217,449	3,975,933	3,882,083
Property and Equipment	721,315	542,485	545,373
Total assets	$ 4,938,764	$ 4,518,418	$ 4,427,456
Liabilities and Net Assets			
Current Liabilities:			
Grants and accounts payable	$ 1,581,156	$ 1,457,726	$ 898,931
Accrued payroll	656,194	632,578	623,354
Accrued vacation pay	664,468	594,956	585,949
Credit line payable	700,000	-	-
Current portion of long-term debt	8,977	8,571	8,190
Total current liabilities	3,610,795	2,693,831	2,116,424
Long Term Liabilities			
Long term debt, less current position	44,581	53,513	62,030
Total liabilities	3,655,376	2,747,344	2,178,454
Net Assets:			
Unrestricted	861,652	1,675,586	2,155,401
Temporarily restricted	421,736	95,488	93,601
Total net assets	1,283,388	1,771,074	2,249,002
Total liabilities and net assets	$ 4,938,764	$ 4,518,418	$ 4,427,456

	Proforma FYE June 30, 2017	2017	2016	2015
Debt Service Coverage - Operating (x)	(4.94)	(13.46)	(25.69)	13.98
Debt to Unrestricted Net Assets (x)	1.22	0.06	0.04	0.03
Margin (%)		(2.81)	(1.78)	(0.47)
Current Ratio (x)		1.17	1.48	1.83

Financial Discussion – Statement of Activities (Income Statement)

ECS has developed a plan that revolves around the purchase and construction of its new facility to recover and stabilize its revenues and expenses to offset negative operating results reflected over the review period.

Over the review period, ECS has experienced operating losses in each fiscal year. However, operating revenues and support increased by $1.8 million or 6.81% between FY 2015 and FY 2017. According to ECS' management, the increase was mainly due to increased cost reimbursement contracts with both federal and county programs. While realizing a growth in support and revenue of 6.8% from FY 2015 to FY 2017, ECS saw increasingly negative changes in unrestricted net assets for each FY as expenses grew 9.3% during the same period. ECS' management notes the losses were an anticipated result of a necessary agency-wide reorganization, which would reflect losses in the short-term, but would result in long-term increases in efficiency and organizational health. The reorganization would allow ECS to break down inefficiencies in patient treatment and centralize administrative functions, thus creating a more cohesive agency with the ability to provide a more seamless transition through ECS' treatment paths for its patients and clients. During the process of its reorganization, ECS incurred unnecessary double rental payments and salaries paid for redundant staffing. These costs will be eliminated moving forward now that the reorganization process is mostly complete. Additionally, with the construction of its new facility, ECS will be able to eliminate rental payments for two facilities.

As a result of the reorganization, expenses increased year after year, from approximately $27.3 million in FY 2015 to $29.8 million in FY 2017. According to ECS' management, the main factors for the increase in expenses were double rents paid to establish a centralized office for administrative functions and additional salaries from the phasing in and out of restructured management positions. ECS' rent expense increased 11% or approximately $1.5 million in FY 2015 to approximately $1.7 million in FY 2017. According to ECS' management, by purchasing its currently leased facility site, ECS will eliminate lease payments of approximately $102,000 per year.

Upon opening in January 2020, ECS' management anticipates increased revenues through greater client volume and three sources of operating income. Those three sources include: (1) drug Medi-Cal reimbursements through County Organized Delivery System for outpatient treatment and intensive outpatient therapy services; (2) non-drug Medi-Cal for outpatient treatment and counseling programs; and (3) reimbursement through private insurance payors. ECS' management anticipates that the new facility will improve its ability to establish contracts with private insurance providers and improve payor mix over time.

Particular Facts to Note

- According to ECS' management, subcontract expenses increased from approximately $60,000 in FY 2015 to approximately $587,000 in FY 2017 due to the establishment of a new federally funded regional grant program that involved subcontracts with other partnering agencies to provide services.
- According to ECS' management, employee training expenses increased from approximately $115,000 in FY 2015 to approximately $254,000 in FY 2017 when ECS added a Quality Assurance Director position as a part of the reorganization to strengthen compliance in FY 2017.

- According to ECS' management, repairs and maintenance expenses increased from approximately $359,000 in FY 2015 to approximately $563,000 in FY 2017 due to significant tenant improvements made across ECS properties to improve safety and quality of treatment locations.

Financial Discussion – Statement of Financial Position (Balance Sheet)

ECS has agreed to additional security on the loan to offset its negative debt service coverage ratio.

In FY 2015, ECS displayed a strong debt service coverage ratio of 13.98x, which then dropped to a (-25.69x) in FY 2016, and remained negative for FY 2017 with a ratio of (-13.46x). According to management, ECS' reorganization led to planned losses in all three FYs with a majority of the financial impact expected in FY 2016 and FY 2017. Those losses negatively impacted their debt service coverage ratios for FY 2016, FY 2017 and pro forma 2017. Moving forward, the combination of the reorganization and opening of the new facility, ECS anticipates reduced expenses and increased revenues, placing it in a positive financial position.

Receipt of a HELP II loan would reflect a pro forma ratio of (-4.94x). Given that ECS has negative debt service coverage ratios, it has agreed to additional security measures including: (1) establishing a debt service reserve fund; (2) submitting quarterly unaudited financial statements; and (3) Authority site visits.

Particular Facts to Note

- According to ECS' management, cash and cash equivalents decreased 41% from approximately $1,000,000 in FY 2015 to approximately $619,000 in FY 2017 due to planned losses as a part of the reorganization. According to ECS' management, cash and cash equivalents were used to sustain the organization during the planned losses associated with the reorganization. ECS has already incurred the majority of its reorganization-related expenses, and expects to replenish its cash and cash equivalents reserve.
- According to ECS' management, grants and accounts receivable increased 49% from approximately $1.7 million in FY 2015 to approximately $2.5 million in FY 2017 due to the increase in support coming from cost reimbursement contracts. Invoices for these contracts are booked as receivables and are generally paid in 45-60 days.

EXHIBIT 1

UTILIZATION STATISTICS

Clients Served/ (Patient Visits)
Fiscal Year Ended June 30,

	2017	2016	2015
Totals	660 / (22,130)	720 / (25,594)	717 / (27,000)

EXHIBIT 2

OUTSTANDING DEBT

Date Issued	Original Amount	Amount Outstanding As of June 30, 2017[a]	Estimated Amount Outstanding after Proposed Financing
-EXISTING LONG-TERM DEBT:			
Comerica Bank Loan, 2013	$ 90,000	$ 53,558	$ 53,558
PROPOSED NEW DEBT			
CHFFA HELP II Loan (2018)			**1,000,000**
TOTAL DEBT		**$ 53,558**	**$ 1,053,558**

[a] Includes current portion of long-term debt.

EXHIBIT 3

BACKGROUND AND LICENSURE

Background

ECS is a licensed nonprofit organization with 30 distinct programs in Santa Cruz County providing services in behavioral health, family and social well-being, early childhood education, housing and more. It is the largest community-based nonprofit in its county. ECS believes that living a healthy life includes access to positive social, economic and educational opportunities.

ECS' mission is to build on the strength of people working together to create health change in their lives and in their community. Encompass prides itself on delivering high quality human services guided by the values of diversity, partnership and the power of workplace democracy.

ECS has four types of service areas, which include:

- **Child and Family Development –** Includes Head Start, Early Head Start, and state pre-kindergarten programs**.**
- **Integrated Behavioral Health–** Includes adult outpatient substance use disorder programs and residential mental health and substance use disorder programs. For youth, it operates the Tyler House Short-Term Residential Therapeutic Program.
- **Community Based Support–** Includes family and social well-being programs, office-based and school-based youth support services, health and housing services, the Santa Cruz AIDS Project, and supportive housing and Housing for Health and Transitional Age Youth programs.
- **Unified Support–** ECS provides executive leadership in four main areas: operations (information technology and human resources), workplace (which includes property services and facilities maintenance), impact (which includes community impact, growth and results measurement), and quality (which includes clinical QA and compliance oversight, accreditation, training and professional development, including evidence-based practice support).

Licensure, Certification, and Accreditation

ECS is licensed and certified by the Department of Health Care Services to operate and maintain drug and alcohol treatment facilities.

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

The HELP II Loan Program

Resolution Number HII-312

RESOLUTION APPROVING EXECUTION AND DELIVERY OF HELP II LOAN PROGRAM AGREEMENTS WITH CERTAIN PARTICIPATING HEALTH INSTITUTIONS

WHEREAS, the California Health Facilities Financing Authority (the "Authority"), a public instrumentality of the State of California, is authorized by the provisions of the California Health Facilities Financing Authority Act (the "Act") to provide secured or unsecured loans to participating health institutions to refinance existing debt and finance the acquisition, construction, expansion, remodeling, renovation, improvement, furnishing, or equipping of a health facility;

WHEREAS, the Authority established the HELP II Loan Program (the "Program") to provide loans to participating health institutions as authorized by the Act;

WHEREAS, **Encompass Community Services** (the "Borrower"), a California participating health institution, has applied to the Authority for a loan through the Program, and the application has been reviewed by the staff of the Authority; and

WHEREAS, approval of the loan by the Authority is now sought;

NOW THEREFORE BE IT RESOLVED by the California Health Facilities Financing Authority, as follows:

<u>Section 1.</u> Pursuant to the Act, the Authority approves a loan to the Borrower in an amount not to exceed **$1,000,000** for a term not to exceed **20 years** for the purpose described in the application filed with the Authority (the "Project"), but solely to the extent there are available proceeds of the Program, as determined pursuant and subject to Section 2 hereof. This approval is further contingent upon the following conditions:

1. 20-year, two percent (2%) fixed rate loan;
2. First lien position on real property located in 161 Miles Lane, Watsonville, CA 95076;
3. A current appraisal that is acceptable to Authority staff;
4. Corporate gross revenue pledge;
5. Loan to value ratio not to exceed 95%;
6. Verification of Borrower's funds to close escrow;
7. Establish a debt service reserve fund, holding two years of loan payments until the new facility opens, at which point one year of loan payments would remain in the fund until ECS' debt service coverage ratio is 1.1x for three consecutive fiscal years;

8. ECS to provide unaudited quarterly financial statements until ECS' debt service coverage ratio is 1.1x for three consecutive fiscal years;

9. ECS agrees to Authority site visits;

10. Provision of an executed construction contract; and

11. Verification of receipt of other funding sources acceptable to Authority staff.

Section 2. The Executive Director is hereby authorized, for and on behalf of the Authority, to determine the final amount, terms and conditions of the loan, and to approve any changes in the Project described in the application submitted to the Authority, as said officer shall deem appropriate and authorized under the Act (provided that the amount of the loans may not be increased above the amount approved by the Authority and provided further that the loans continue to meet the Authority's guidelines for HELP II loans). Nothing in this resolution shall be construed to require the Authority to obtain any additional funding, even if more loans are approved than there is available funding. Any notice to the Borrower shall indicate that the Authority shall not be liable to the Borrower in any manner whatsoever should such funding not be completed for any reason whatsoever.

Section 3. The Executive Director is hereby authorized and directed, for and on behalf of the Authority, to draw money from the Program fund not to exceed those amounts approved by the Authority for the Borrower. The Executive Director is further authorized and directed, for and on behalf of the Authority, to execute and deliver to the Borrower any and all documents necessary to complete the transfer of funds.

Section 4. The Executive Director of the Authority is hereby authorized and directed to do any and all things and to execute and deliver any and all documents which the Executive Director deems necessary or advisable in order to effectuate the purposes of this resolution and the transactions contemplated hereby, and which have heretofore been approved as to form by the Authority.

Section 5. This resolution expires twelve months from the date of approval.

Date of Approval: ______________________