CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY (Authority)

Commercial Paper Program

Resolution No. 2023-05

July 27, 2023

PURPOSE OF THE REQUEST

Staff requests that the Authority approve certain parameters deemed necessary to consider the issuance of commercial paper notes (CP) by the Authority at the request of eligible participating health institutions. The Authority's Bond Financing Program considers the issuance of long-term fixed rate or variable rate bonds, while the requested approval relates to establishing commercial paper financing programs for the short-term financing needs of participating health institutions (or borrowers). In anticipation of expected financing requests by borrowers, staff requests the Authority consider establishing parameters for considering the establishment of CP programs. In connection with establishing a CP Program, staff has prepared descriptions of what CP is, how it works, the benefits provided for certain borrowers, and the impact on the Authority.

<u>What is CP?</u>

CP is a financing vehicle implemented through the issuance of notes in the short-term municipal market. The short-term CP notes are structured with maturities ranging from 1 to 270 days. The interest rate on each CP note is fixed at the time of issuance, based on market conditions. The interest rate on a CP note changes when the CP note matures and new CP is issued to refund the existing CP. This is referred to as a "roll over" CP note. The "roll over" note is issued with a new interest rate and a new maturity. A CP program typically consists of multiple issuances of CP notes which, when taken as a whole, produces an overall variable rate borrowing cost. CP is issued in minimum denominations of $100,000 or integral multiples of $1,000 in excess thereof. The combination of this minimum denomination and maximum maturity of 270 days, allows the security to be exempt from the continuing disclosure requirements of Securities and Exchange Commission Rule 15c2-12.

CP is typically purchased by institutional investors (short-term money market funds) and is often supported by a bank credit facility to achieve the highest credit quality; however higher rated health care borrowers may be able to utilize self-liquidity. Due to the unlikely, but possible, risk that market conditions would not support the issuance of new CP notes at the time that the outstanding CP notes mature, borrower self-liquidity or bank-supported liquidity facility is required to ensure funds are available to provide payment for CP notes maturing. The ratings applied to CP generally reflect the ratings of the entity providing the liquidity support. Therefore, backed by a highly rated borrower or bank liquidity, CP program ratings generally carry the strong short-term ratings of A-1+ and A-1 (Standard & Poor's), P-1 (Moody's) and F-1+ and F-1 (Fitch), again, which are reflective of the rating of the liquidity provider and/or borrower.

<u>How does it work?</u>

CP requires several parties for issuance similar to that of a variable rate demand bond issue: an appointed bank underwriting, sales, and trading platform (CP Dealer) to sell the CP notes; a bank serving in the capacity of an Issuing and Paying Agent (IPA) to coordinate issuances, receive/release funds and pay principal and interest to investors (sometimes also assuming the role of Trustee if the CP is issued pursuant to a bond indenture); the Depository Trust Company (DTC) for registration of CP notes; investors, the borrower(s), and an issuer (the Authority).

Based upon the request of the borrower and the authorization provided by the Authority, the CP Dealer's sales force markets a new issuance of CP and coordinates note placement and trade activities with the IPA. Upon each maturity date, CP notes are generally rolled over automatically (unless the borrower wishes to pay the CP notes at maturity) without requiring specific authorization or instructions by the borrower or the Authority. The Authority would authorize the entire program prior to inception and would not need to be involved on a trade-by-trade basis. If the overall size of the program were to be increased, such a change would have to be brought back to the Authority for approval.

Tax-exempt (or taxable) money market funds are the primary purchasers of CP. On each day the CP is to be placed, the CP Dealer will present a broad maturity scale with corresponding interest rates to potential investors. Interest rates established for each maturity consider economic and technical trends in the marketplace, and additionally reflect information received from recent trading activity. By providing a broad range of choices, it allows money market funds to select the best option for their specific portfolio needs. Maturities generally average between 30 and 60 days, but borrower objectives and market conditions may support longer maturity trades.

What are the benefits?

With a traditional bond issue, whether fixed or variable rate, all bond proceeds are deposited with the Trustee at the time of closing. Borrowers typically issue bonds in an amount sufficient to fund one or more construction projects in their entirety. Federal tax laws governing tax-exempt bonds generally require a reasonable expectation that the proceeds will be spent within three years on construction projects. Thus, borrowers must issue bonds up front in amounts sufficient to complete extended project timelines. Even if capitalized interest is funded from bond proceeds to pay bond interest costs during construction, the original issue size must be increased to cover both construction and capitalized interest costs, resulting in a higher overall cost for the bonds.

For certain health care entities, CP may be a more efficient mechanism for financing numerous or extended projects. First, CP note issuance can be timed to coincide with the exact timing of the funding need. Since projects typically are segregated into phases, each phase or components within each phase can be funded only when needed; associated finance costs are therefore phased in as well. Further, contribution funds designated for projects can be utilized as received in lieu of additional CP note issuance for better overall management of debt.

What is the Impact on the Authority?

Essentially, the initial application and Authority approval process would be similar to the process under the Authority's Bond Financing Program. Initially, a borrower would work with Authority staff to establish a CP program, which would include their proposal of certain CP program terms that would be tailored to their specific needs such as the maximum aggregate of CP to be outstanding at any one time, a list of projects anticipated to be funded by CP, and the final maturity date for the CP program, in addition to the CP meeting the minimum requirements as set forth by the resolution.

The minimum requirements set forth in the resolution are as follows:

a) any CP to be issued by the Authority must receive short-term ratings of at least A-1/P-1/F-1 (Standard & Poor's/Moody's/Fitch) by at least one nationally recognized rating agency; b) the CP to be issued must be in denominations of $100,000 or integral multiples of $1,000 in excess thereof; c) the final maturity date of the CP cannot exceed 40 years as provided under the Act; and d) the CP Program Application must include a detailed description of the capital projects anticipated to be funded by the proceeds of the CP as currently required in other applications of the Authority.

Documents would be drafted relating to the CP program and reviewed by the relevant parties and counsel. With the approval of the Authority of the application and relevant CP program documents, the Authority will be authorized to issue CP from time to time at the direction of the borrower, subject to the parameters of the CP program.

As each CP note is issued, staff may require the borrower to provide issuance details, such as the par amount of the CP note, the projects to be financed, and the aggregate amount of CP notes outstanding under the program's authorized par amount to ensure the CP notes comply with the program requirements. Staff may also require the borrower to report any principal reductions that coincide with roll-overs so that debt outstanding can be monitored by the Authority.

The Authority's sister agency, the California Educational Facilities Authority (CEFA) has a CP program in use by one borrower since 2008. In 2022, CEFA implemented a CP fee structure similar to the CEFA Bond Financing Program fee structure. Staff proposes to implement a CP fee structure using the same approach.

	BOND FINANCING PROGRAM	**CP PROGRAM**
Application Fee	$0	$0
Initial Fee (due at closing)	0.05% of aggregate amount of issue, up to a maximum of $100,000	0.05% of aggregate amount of issue, up to a maximum of $100,000
Annual Administration Fee	0.175% of bonds outstanding, up to a maximum of $150,000	Greater of $5,000 or 0.0175% of the maximum amount of notes outstanding during the billing year

SUMMARY

CP is not for all borrowers. Borrower self-liquidity or third-party liquidity is required, as with variable rate bond issuances. Ratings are either based on underlying ratings of the health care borrower (only relevant to the highest rated borrowers with robust liquidity) or on the ratings of bank providing credit and/or liquidity enhancement. Further, borrower staff time is required for the continual monitoring of new placements, roll-overs of matured CP notes and principal and interest payments.

Overall, the Authority anticipates a limited number of borrowers to request Authority approval of a CP program; however, staff has received requests from some borrowers. Staff recommends the Authority approve basic parameters and minimum requirements of a CP program. Staff may then respond to a borrower's request of a CP program on a case-by-case basis.

RECOMMENDATION

Staff recommends the Authority approve Resolution No. 2023-05, adopting certain parameters and minimum requirements deemed necessary to establish a CP program.

RESOLUTION NO. 2023-05

RESOLUTION OF THE CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY AUTHORIZING CONSIDERATION OF POTENTIAL APPLICATIONS FOR THE ISSUANCE OF COMMERCIAL PAPER PROGRAMS

WHEREAS, the California Health Facilities Financing Authority (the "Authority") is a public instrumentality of the State of California, created by the California Health Facilities Financing Authority Act (constituting Part 7.2 of Division 3 of Title 2 of the Government Code of the State of California) (the "Act"), and is authorized to issue bonds (including notes) and to loan the proceeds to any participating health institution (as defined in the Act and referred to herein as "Eligible Borrowers") to finance construction, expansion, remodeling, renovation, furnishing, equipping, and acquisition of health facilities (including by reimbursing expenditures made for such purpose) and to refund and refinance certain indebtedness; and

WHEREAS, from time to time, the Authority has issued bonds and notes at the request of Eligible Borrowers bearing interest at fixed or variable rates; and

WHEREAS, the Authority has received indications of interest from Eligible Borrowers for the issuance of Commercial Paper notes on a tax-exempt and/or taxable basis ("CP") as an alternative to fixed or variable rate bonds; and

WHEREAS, CP, as a note, is included within the meaning of "bonds" under the Act because the definition thereof includes notes and other evidence of indebtedness issued by the Authority; and

WHEREAS, the Authority desires to adopt certain parameters deemed necessary in order to consider the issuance of CP pursuant to CP programs to be proposed by Eligible Borrowers from time to time and to authorize staff to receive, analyze and present for approval to the Authority applications and related documents received from Eligible Borrowers whereby Eligible Borrowers propose a CP program and request the issuance of CP by the Authority;

NOW, THEREFORE, BE IT RESOLVED by the Authority as follows:

<u>Section 1.</u> The Authority will accept and consider applications proposing CP programs from Eligible Borrowers requesting the issuance of CP by the Authority ("CP Program Applications"), provided that the CP Program Application meets the following minimum requirements: a) any CP to be issued by the Authority must receive short-term ratings of at least A-1/P-1/F-1 (Standard & Poor's/Moody's/Fitch) by at least one nationally recognized rating agency; b) the CP to be issued must be in denominations of $100,000 or integral multiples of $1,000 in excess thereof; c) the final maturity date of the CP cannot exceed 40 years as provided under the Act; and d) the CP Program Application must include a detailed description of the capital projects anticipated to be funded by the proceeds of the CP as currently required in other applications of the Authority.

Section 2. CP Program Applications must be accompanied by drafts of all documents related to the CP to which the Authority is a party and other documents deemed necessary by bond counsel and Authority counsel. Such documents will be subject to approval by the Authority in conjunction with consideration of the CP Program Application.

Section 3. The Authority hereby approves the following fees for the CP program:

A. An initial fee of 0.05% up to a maximum of $100,000; and

B. An annual administration fee of 0.0175% of the maximum amount of notes outstanding during the billing year or $5,000; whichever is greater.

Section 4. Notwithstanding the requirements set forth in Sections 1 and 2 of this resolution, the Authority may determine that additional requirements must be met or that additional covenants must be included in particular CP programs in order to obtain Authority approval.

Section 5. This resolution shall take effect immediately.

Date of Approval: ______________________________