

**CHOOSING THE BEST FINANCING  
OPTION  
FOR YOUR HEALTH CARE FACILITIES**

Pennsylvania Bar Institute  
Health Law Institute  
March 12, 2019

John Brodsky  
Senior Vice President and Treasurer  
Lehigh Valley Health Network  
Allentown, Pennsylvania

Kevin Connell  
Director  
Echo Financial Products  
King of Prussia, Pennsylvania

Kevin Cunningham  
Partner  
Ballard Spahr LLP  
Philadelphia, Pennsylvania

# I. Traditional Sources of Capital Financing for Not-for-Profit Health Care Providers

---

- A. Gifts, grants and bequests
- B. Retained earnings
- C. Debt
- D. Equity investment generally not an option

# II. Categories of Debt Financing

---

- A. Bank loans
- B. Privately placed debt
- C. Publicly sold debt
- D. Taxable or tax-exempt –
  - does holder of the debt pay income tax on the interest

# III. Basic Mechanics of tax-exempt financings

---

- A. Government entity is the issuer of the debt
- usually a state-level authority or a local government or authority
  - in Pennsylvania these are usually municipality authorities or industrial development authorities
  - usually no recourse to the issuer for payment of the debt

# III. Basic Mechanics of tax-exempt financings (cont'd)

---

B. Proceeds of the debt are made available to the health care providers

- usually a loan agreement
- can be an installment sale or lease–leaseback
- borrower agrees to pay all the debt service and related transaction costs

# III. Basic Mechanics of tax-exempt financings (cont'd)

## C. The debt is placed with investors

- If debt is sold to public investors, an underwriter is used to sell the debt (and the financing is referred to as a “bond issue”)
- If debt is privately placed (usually with an insurance company or an investment fund), often a placement agent is retained to negotiate the terms of the transaction
- If the debt is placed with a bank, the borrower will sometimes use a financial advisor to assist in selecting a bank and negotiating terms

# III. Basic Mechanics of tax-exempt financings (cont'd)

## D. Documentation

- For public offerings, there is a trust indenture with a trustee
- For private placements, there is also often a trust indenture
- For bank transactions, the documentation often consists of a three-party loan agreement among the issuer, the borrower and the lender
- In each case there will be a loan agreement or similar instrument under which the borrower agrees to pay the debt service – and form the credit structure to support future parity obligations

# III. Basic Mechanics of tax-exempt financings (cont'd)

## E. Covenants, Security and Collateral

- Typically the payment obligations of the Borrower will be evidenced by a loan agreement and promissory note
- The promissory note may be a master note issued under a master trust indenture, under which the Borrower and one or more of its affiliates are jointly and severally liable
- A debt service reserve fund may be established for the bonds and funded with bond proceeds
- The documentation will usually contain covenants limiting the borrower's ability to incur additional indebtedness; to merge or consolidate with other entities; and to encumber or transfer its assets



# III. Basic Mechanics of tax-exempt financings (cont'd)

## E. Covenants, Security and Collateral (cont'd)

- Often there will be a pledge of gross revenues by the Borrower (or the obligated group in a master indenture structure)
- Liquidity and to a lesser extent leverage tests may be used
- Sometimes there will also be a mortgage on the borrower's facilities – has become rare for all but the most marginal credits
- A “negative pledge” – a covenant not to give other creditors a mortgage on core assets – is common in financings that are not secured by a mortgage on those assets
- A pledge of cash or investment securities is generally not done because of the potential for yield restriction or rebate or arbitrage profits to the United States Treasury

# III. Basic Mechanics of tax-exempt financings (cont'd)

## F. Disclosure Materials

- In connection with public offerings, an offering document (usually called an “official statement”) is printed or made available online to potential investors
  - Summary description of the transaction, Borrower, deal terms, use of proceeds, federal income tax status of interest

# III. Basic Mechanics of tax-exempt financings (cont'd)

## F. Disclosure Materials (cont'd)

- Appendix A – Detailed description of the Borrower
- Appendix B – Audited Financial Statements
- Appendix C – Summary of Legal Documents
- Appendix D – Form of Bond Counsel Opinion

# III. Basic Mechanics of tax-exempt financings (cont'd)

---

## G. Closing Documents

- At closing, various documents are delivered, including certificates, tax-related documentation, and legal opinions as to the validity and enforceability of the various financing documents

# IV. Types of Facilities that are Eligible for Tax-Exempt Financing

## A. Capital Facilities

- Generally speaking, the facilities must be capital facilities under GAAP
- Term of the financing is limited to 120% of the weighted average economic life of the assets

## B. The owner must be an IRC Section 501(c)(3) organization

## IV. Types of Facilities that are Eligible for Tax-Exempt Financing (cont'd)

- C. The facilities generally must be used by the owner in furtherance of its exempt functions (i.e., not in connection with an unrelated trade or business)
- D. The Internal Revenue Code sharply limits the use of bond-financed facilities by for-profit businesses or other non-exempt persons (such as doctors in their private practices)

# V. Overview of Legal Considerations

---

## A. Validity and enforceability issues

- The issuer must have legal authority to issue and sell or place the debt
- The terms of the debt must fit within statutory constraints applicable to the issuer (especially with regard to the use of proceeds, the nature of the borrower and the term of the debt)
- The issuer must meet to authorize the financing

# V. Overview of Legal Considerations

(cont'd)

---

## A. Validity and enforceability issues (cont'd)

- Approvals of other local government bodies may also be required for the financing. In Pennsylvania, health, safety and welfare determinations are required for municipality authority financings
- The borrower must have the legal authority to borrow the debt proceeds, repay the loan and own and operate the financed facilities



# V. Overview of Legal Considerations

(cont'd)

---

## B. Tax-exemption issues

- The facilities must be eligible for tax-exempt financing (depends in part on how facilities are to be used)
- The facilities must be used in accordance with applicable limits, such as limits on private business use

# V. Overview of Legal Considerations

(cont'd)

---

## B. Tax-exemption issues (cont'd)

- For “private activity bonds” (such as bonds issued for 501(c)(3) organizations), approval of the financing is required to be obtained from the highest elected official in the jurisdiction in which the issuer is located (and, if different, in the jurisdiction where the financed facilities are located), after notice and a public hearing
- At closing, the issuer and borrower execute certificates stating their expectations as to the use of the debt proceeds, and the issuer is required to file an information return with the IRS on Form P038

# V. Overview of Legal Considerations

(cont'd)

---

## B. Tax-exemption issues (cont'd)

- The Internal Revenue Code and regulations contain restrictions on the use of the financed facilities, on the investment of bond proceeds and on required rebate to the U.S. Treasury of certain investment earnings on bond proceeds
- The Borrower is responsible for on-going compliance with tax rules to preserve tax-exemption of interest on bonds and on-going filing of Schedule K of IRS Form 990
- Refinancing of tax-exempt debt with new tax-exempt is generally possible on a current refunding basis but is generally no longer available on an advance refunding basis

# V. Overview of Legal Considerations

(cont'd)

---

## C. Securities Law Issues

- The offer and sale of the bonds to the public will generally be exempt from the registration requirements of the Securities Act of 1933, as amended
- However, the anti-fraud provisions of the federal securities laws, including Rule 10b.5, do apply to the offer and sale of bonds to the public

# V. Overview of Legal Considerations

(cont'd)

---

## C. Securities Law Issues (cont'd)

- In addition, Rule 15c2-12 under the Securities Exchange Act of 1934, as amended, imposes an obligation on the underwriters of municipal bonds to make sure that the obligor (in this case, the borrower of the bond proceeds) has agreed to make certain financial and operating data available on the Municipal Securities Rulemaking Board's "EMMA" website pursuant to a "continuing disclosure undertaking"

# VI. Public Offerings vs. Private Placements

---

A. Public offerings of bonds provide the only option for long-term financings (typically 30-40 years) for long-lived assets such as buildings.

# VI. Public Offerings vs. Private Placements (cont'd)

- B. The process is, however, typically more involved and more expensive than a private placement or bank loan, because it usually involves:
- one or more underwriters to sell the bonds (and underwriters' counsel);
  - a trust indenture and a trustee (and trustee counsel);
  - securities ratings from one or more rating agencies (Fitch, S&P, Moody's);
  - An offering document (with detailed Borrower disclosure) such as an official statement for use in selling the bonds to investors;
  - An extensive marketing period in preparation for the sale of bonds; and
  - a continuing disclosure undertaking.

# VI. Public Offerings vs. Private Placements (cont'd)

C. In some cases the bonds will be sold more easily, and at lower interest rates, if the borrower provides “credit enhancement” such as bond insurance, or, for certain types of variable rate demand bonds, “liquidity enhancement” in the form of a line of credit or standby bond purchase agreement from a qualified bank. Bond insurance was once very common for healthcare bonds. This is no longer the case as most of the bond insurers went out of business in the 2008/2009 market disruption.



# VI. Public Offerings vs. Private Placements (cont'd)

---

D. A direct placement of bonds with a financial institution (such as an insurance company or an investment fund) may shorten the process and eliminate some complexity (for example, the investor may not require an offering document).

# VI. Public Offerings vs. Private Placements (cont'd)

- E. Bonds in the form of bank loans are usually the fastest, cheapest and easiest to get done, since they do not require an underwriter or a placement agent, there are no offering materials, and banks often will not require a securities rating from a rating agency; however:
- the bank is unlikely to offer a financing term in excess of seven or ten years;
  - the interest cost on the financing may be lower than the interest cost on publicly offered bonds but the relatively short term of the bank financing introduces renewal risk and interest rate risk that would not be found in publicly offered fixed rate bonds; and
  - the bank will often require more stringent covenants and may be more likely to require collateral such as a mortgage for smaller or lower rated entities.

# VI. Public Offerings vs. Private Placements (cont'd)

---

F. On the other hand, when the debt is owned by a bank, it is often easier to obtain waivers or consents from the bank than it would be from a group of bondholders, and the bank may permit prepayments, in contrast to the typical 5-10 year no-call period for publicly offered fixed rate bonds

## VII. Legal Opinions required for a Tax-Exempt Underwriting (cont'd)

---

### A. Bond Counsel opinion

- A. Approving opinion (validity and tax exemption)
- B. Supplemental opinion (no registration; accuracy of document descriptions in the offering document)

### B. Underwriter's Counsel's Opinion

### C. Borrower's Counsel Opinion

### D. Others-typically includes Trustee Counsel, Authority Counsel, and Credit Enhancer Counsel (if any)

# VIII. Other Parties to an Underwriting

(cont'd)

---

- Financial Advisors
- Swap Counterparties, Swap Advisors
- Auditors (stub period reviews)
- Verification Agents (for certain refunding transactions)
- Rating Agencies

# IX. Disclosure Considerations

---

- A. For public offerings of bonds, the borrower is required to provide prospective investors with the information reasonably required to make an investment decision. This typically includes:
- a narrative description of the terms of the bonds and their security;
  - summaries of the principal legal documents;
  - a narrative description of the borrower, its services and facilities, service area and competition, governance and management, medical staff, and financial and operating results, including historical utilization information; and
  - at least two years of audited financial statements.

# IX. Disclosure Considerations

(cont'd)

- B. The consequences of a material misstatement or omission in the offering document can be severe, including private litigation by purchasers of the bonds or enforcement action by the Securities and Exchange Commission.
- C. The borrower will generally be required to indemnify the issuer and the underwriter against securities law liabilities.

# IX. Disclosure Considerations

(cont'd)

D. The borrower will generally be required, as long as the bonds are outstanding, to file on the MSRB's EMMA (Electronic Municipal Market Access) system its annual audited financial statements, the other financial and operating data used in connection with the original sale of the bonds, and notice of the occurrence of various designated events (such as payment defaults, certain covenant defaults, mergers and acquisitions, bankruptcy, rating changes, etc.).



# IX. Disclosure Considerations

(cont'd)

- E. The continuing disclosure requirement is the SEC's effort to inject greater transparency and better information into the municipal bond marketplace.
- F. The Borrower may engage a dissemination agent to post its ongoing disclosure requirements.
- G. Amendments to Rule 15c2-12 effective in late February 2019 require Borrowers to post on the EMMA system disclosure of certain financial and hedging transactions (including bank loans and interest rate swaps) as well as defaults or similar events related to those transactions

# X. Post-Issuance Considerations

- A. Tax-related. The borrower must observe various requirements of the tax laws regarding bond proceeds and the use of bond-financed property. Failure to observe these requirements can result in the bonds losing their tax-exempt status and interest becoming includible in the income of the holder of the bonds – not a result they will be happy about.
- A change in the use of bond-financed facilities, even years after the bonds were issued, can result in required remedial action, such as payment or redemption of the related bonds. Examples of a change in use include the sale or lease of the facility to an entity that is not an exempt organization.
  - It may be necessary to calculate and pay arbitrage profits to the United States Treasury

# X. Post-Issuance Considerations

(cont'd)

B. Securities-related. The borrower must observe the requirements of any continuing disclosure undertaking it has made in connection with the public offering of bonds. Failure to do so may result in lack of market information regarding the bonds and reduced liquidity in the market. Brokers may be unable to recommend the purchase by their customers of bonds for which secondary market disclosure is not being made on a timely basis by the borrower. This could have adverse consequences for the borrower the next time it brings its bonds to market.

# XI. Indicative Financing Schedule (cont'd)

---

- A. An indicative financing schedule follows, showing the sequence of events for a typical tax-exempt public offering of healthcare bonds.

# Indicative Financing Schedule




## INDICATIVE FINANCING SCHEDULE 2019 IAX-EXMPT REVENUE BONDS

June					July					August					September									
S	M	T	W	T	S	M	T	W	T	S	M	T	W	T	S	M	T	W	T					
				1	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26
16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	1	2	3	4	5	6	7	8	9
23	24	25	26	27	28	29	30	31		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
30																								

Denotes Bond Market Holidays

Week of	Date	Activity	Participants
May/June		Review Project to be financed and Tax-Exempt Funding Eligibility Issue Credit Provider RFP, if required Issue Underwriter RFP, if required	IL, HC, FA H, FA H, FA
July	7-8-15	Due Date of Credit Provider RFP Due Date of Underwriter RFP Plan of Finance Determined (Credit Provider and Underwriter Selected) Working Group conference calls - TBD Rating Agency and Appendix A Data Request Schedule Rating Presentation	IL, FA All H, FA FA
August		Working Group conference calls - TBD 1 <sup>st</sup> Draft of Appendix A 1 <sup>st</sup> Draft of Rating Presentation Review rating presentation 1 <sup>st</sup> Draft of Bank and Bond Documents (Loan and Trust Agreement, Preliminary Official Statement, Bond Purchase Agreement, Continuing Disclosure Agreement)	All IL, HC, FA IL, U, FA IL, U, FA BC, U, CC
September		Working Group conference calls - TBD 2nd Draft of Appendix A, including 6 month financials 2nd Draft of Rating Presentation Review rating presentation 3rd Draft of Bank and Bond Documents Draft of Board Resolution for Finance Committee Consideration Finance Committee Meeting and Approval Board Meeting and Approval Submit additional rating information to Rating Agencies Circulate draft consent, language and Agree Upon Procedures Working Group conference call - TBD 3rd Draft of Appendix A 3rd Draft of Bank and Bond Documents Finalize rating presentation Rating call - TBD Submit Bank Bond Documents and Final Resolution to Authority Authority Meeting - TBD	All IL, HC, FA IL, U, FA H, U, FA BC, U, CC HC H, HC IL, HC H, U, FA IL, A All H, HC, FA BC, U, CC IL, U, FA H, RA, U, FA H, BC H, HC, FA

# Indicative Financing Schedule

		<b>INDICATIVE FINANCING SCHEDULE</b> <b>2019 TAX-EXEMPT</b> <b>REVENUE BONDS</b>																																																																																															
<table border="1"> <thead> <tr> <th colspan="5">October</th> <th colspan="5">November</th> </tr> <tr> <th>S</th><th>M</th><th>Tu</th><th>W</th><th>Th</th><th>F</th><th>S</th> <th>S</th><th>M</th><th>Tu</th><th>W</th><th>Th</th><th>F</th><th>S</th> </tr> </thead> <tbody> <tr> <td></td><td></td><td>1</td><td>2</td><td>3</td><td>4</td><td>5</td> <td>1</td><td>2</td><td></td><td></td><td></td><td></td><td></td> </tr> <tr> <td>6</td><td>7</td><td>8</td><td>9</td><td>10</td><td>11</td><td>12</td> <td>1</td><td>4</td><td>5</td><td>6</td><td>7</td><td>8</td><td>9</td> </tr> <tr> <td>13</td><td>14</td><td>15</td><td>16</td><td>17</td><td>18</td><td>19</td> <td>10</td><td>11</td><td>12</td><td>13</td><td>14</td><td>15</td><td>16</td> </tr> <tr> <td>20</td><td>21</td><td>22</td><td>23</td><td>24</td><td>25</td><td>26</td> <td>17</td><td>18</td><td>19</td><td>20</td><td>21</td><td>22</td><td>23</td> </tr> <tr> <td>27</td><td>28</td><td>29</td><td>30</td><td>31</td><td></td><td></td> <td>24</td><td>25</td><td>26</td><td>27</td><td>28</td><td>29</td><td>30</td> </tr> </tbody> </table>		October					November					S	M	Tu	W	Th	F	S	S	M	Tu	W	Th	F	S			1	2	3	4	5	1	2						6	7	8	9	10	11	12	1	4	5	6	7	8	9	13	14	15	16	17	18	19	10	11	12	13	14	15	16	20	21	22	23	24	25	26	17	18	19	20	21	22	23	27	28	29	30	31			24	25	26	27	28	29	30	<small>Denotes Bond Market Holidays</small>	
October					November																																																																																												
S	M	Tu	W	Th	F	S	S	M	Tu	W	Th	F	S																																																																																				
		1	2	3	4	5	1	2																																																																																									
6	7	8	9	10	11	12	1	4	5	6	7	8	9																																																																																				
13	14	15	16	17	18	19	10	11	12	13	14	15	16																																																																																				
20	21	22	23	24	25	26	17	18	19	20	21	22	23																																																																																				
27	28	29	30	31			24	25	26	27	28	29	30																																																																																				
Week of	Date	Activity	Participants																																																																																														
October 7		Receive Rating Working Group conference call - TBD	RA All																																																																																														
October 15-21		Receive Final Audit Due Diligence Call Receive Auditor Consent Letter and final ACP Finalize, Print and Mail Preliminary Official Statement Investor Call Meeting	H, A II, IIC, U.C., FA H, A, FA All H, I, FA																																																																																														
October 28		Pre-closing call Bond Pricing Sign RPS Finalize, Print and Mail Official Statement Draft of Closing Documents Working Group conference call - TBD	H, I, FA II, I, FA H, I All BC, HC, I, U, C All																																																																																														
November 4		All Documents Finalized Working Group conference call - TBD	All All																																																																																														
November 11	11/13 11/14	Pre-Closing Closing	All All																																																																																														
Participants																																																																																																	
<b>H</b>	Hospital																																																																																																
<b>HC</b>	Hospital Counsel																																																																																																
<b>I</b>	Issuer																																																																																																
<b>IC</b>	Issuer's Counsel																																																																																																
<b>BC</b>	Bond Counsel																																																																																																
<b>U</b>	Underwriter																																																																																																
<b>UC</b>	Underwriter's Counsel																																																																																																
<b>FA</b>	Financial Advisor																																																																																																
<b>T</b>	Trustee																																																																																																
<b>TC</b>	Trustee Counsel																																																																																																
<b>A</b>	Auditor																																																																																																
<b>RA</b>	Rating Agencies																																																																																																