**CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY**
**EXECUTIVE SUMMARY**

| | | | |
|---|---|---|---|
| **Applicant:** | Hope Rehabilitation Services ("Hope")<br>Santa Clara, California<br>(Santa Clara County) | **Amount Requested:**<br>**Date Requested:**<br>**Requested Loan Term:** | $6,000,000<br>April 25, 2002<br>18 years |
| **Facility Types:** | Adult day care and other services for the developmentally disabled. | **Resolution Number:** | F-292 |

**Uses of Bond Proceeds:** Current refunding of Authority debt, with projected present value savings of $582,000 or approximately 10.7% of the refunded bonds.

**See Page 2 for discussion of current status of existing bonds.**

**Type of Issue:** Negotiated public offering with fixed rates.
**Credit Enhancement:** Cal-Mortgage Insurance (Preliminary Commitment approval April 10, 2002)
**Expected Credit Rating:** A+ (S&P), based on Cal-Mortgage Insurance.
**Senior Underwriter:** U.S. Bancorp Piper Jaffray
**Co-obligors:** The Foundation for Hope, Skills Center, Inc.
**Bond Counsel:** Quint & Thimmig LLP

**Financial Overview*:*** Hope continues to experience unprofitable operations, resulting in inadequate debt coverage. However, the organization draws strength from community support and diversity of revenue. Although Hope continues to rely on short-term financing, its balance sheet is strong. This refunding is one of several cost saving measures Hope is undertaking to return to profitability.

| **Sources of Revenue (in millions):** | | Amount | Percent |
|---|---|---|---|
| (FYE 6/30/01) | Government funding | $17 | 55% |
| | Contracts | 8 | 26% |
| | Donations | 5 | 16% |
| | Other | 1 | 3% |
| | | $ 31 | 100% |

| **Estimated Sources of Funds ( 000's):** | | **Estimated Uses of Funds ( 000's):** | |
|---|---|---|---|
| Par Amount of CHFFA Bonds | $6,000 | Current refunding | $5,502 |
| Transfer from prior reserve funds | 650 | Debt service reserve fund | 488 |
| Original issue discount | (150) | Insurance premium | 260 |
| | | Costs of Issuance | 250 |
| Total Sources | $6,500 | Total Uses | $6,500 |

**Legal Review:** No information was disclosed to question the financial viability or legal integrity of the Applicant.

**Staff Recommendation**: Staff recommends the Authority approve a Resolution in an amount not to exceed $6,000,000 for Hope Rehabilitation Services subject to a final insurance commitment from Cal-Mortgage, producing a rating in the "A" category.

## STAFF SUMMARY AND RECOMMENDATION

### Hope Rehabilitation Services Inc. ("Hope")

April 25, 2002
Resolution Number: F-292

**I. PURPOSE OF FINANCING:** Hope proposes to use bond proceeds to current refund its 1990 bonds issued by the Authority for interest expense savings.

***Current refunding........................................................................................ $5,502,000***

Hope intends to use roughly $5.5 million to current refund bonds issued in 1990 through the Authority. The average interest rate of the refunded bonds is approximately 7.3%.

Net present value savings is projected to be $582,000 or 10.7% of the refunded bonds.

<u>Status of existing bonds</u>

Under the existing loan agreement, Hope covenanted to take sufficient actions to produce a debt service coverage ratio equal to at least 1.20 times the maximum aggregate annual debt service amount. However, Hope only achieved debt service coverage ratios of 1.05x for fiscal 2001, 0.22x for fiscal 2000 and 0.19x for fiscal 1999. In addition, the loan agreement required Hope to submit annual audited financial statements within 120 days of fiscal year-end. For 2000 and 2001, Hope did not submit audited financial statements within the required time period. As a result, Hope is in technical default of its existing bonds. Issuance of the fiscal 2001 financial statements was delayed pending resolution of the accounting treatment of several items.

Last month, Cal-Mortgage agreed to defer any remedial action on these defaults until July 1, 2002, and required Hope to submit an action plan to cure the defaults (see page 7 for a discussion of Hope's deficit reduction plan). In addition, the Authority provided Hope with a letter waiving the 2001 defaults until March 31, 2002.

Because of Hope's weak financial results, Cal-Mortgage has strengthened its security position with additional liens on several properties that were previously not pledged. The addition of The Foundation for Hope as an co-obligor provides additional security.

| | | |
|---|---|---|
| ***Other financing costs are as follows*** | | ***998,000*** |
| Debt service reserve | $488,000 | |
| Maximum bond insurance costs | 260,000 | |
| Estimated issuance costs | 250,000 | |
| *Total Uses of Funds* | | ***$6,500,000*** |

Structure of Financing:

- Fixed rate bonds, with an 18 year maturity date (the remaining maturity of the refunded bonds).
- Cal-Mortgage insurance.
- Negotiated public offering.
- Expected Credit Rating: A+ (S&P), (Based on Cal-Mortgage insurance).
- Joint and several obligation of Hope Rehabilitation Service, The Foundation for Hope, and Skills Center, Inc.*

* See the “Background” section for a further description of the above corporate entities.

## II. FINANCIAL STATEMENTS AND ANALYSIS

**HOPE Rehabilitation Services, The Foundation for HOPE, and Skills Center, Inc.**
**Combined Statements of Activity ($000's)**
**(Unrestricted)**

| | For the 8 months ended 2/28/02 (Unaudited) | For the year ended June 30 2001 | 2000 | 1999 |
|---|---|---|---|---|
| **Unrestricted Revenue:** | | | | |
| Federal, state and county funds | $ 11,922 | $ 17,322 | $ 14,979 | $ 13,891 |
| Contract services | 4,110 | 7,605 | 7,198 | 6,338 |
| In-kind donations of services | 943 | 1,077 | 1,042 | 1,187 |
| Sales of salvage, net | 1,453 | 2,285 | 2,159 | 1,973 |
| Contributions and pledges | 1,124 | 1,331 | 1,219 | 827 |
| Gain on sale of property | - | 795 | - | - |
| Investment income | (16) | 85 | 111 | 399 |
| Net assets released from restrictions | - | 280 | 134 | 7,504 |
| Other revenue | 94 | 192 | 720 | 387 |
| Total support and revenue | 19,630 | 30,972 | 27,562 | 32,506 |
| **Expenses:** | | | | |
| Personnel costs | 15,170 | 22,023 | 20,910 | 18,672 |
| Occupancy | 1,623 | 2,152 | 1,770 | 1,636 |
| Purchased services | 985 | 1,823 | 1,866 | 1,146 |
| Supplies | 905 | 1,729 | 1,872 | 1,185 |
| Interest | 338 | 708 | 616 | 567 |
| Bad debt expense | (2) | 14 | 202 | 265 |
| Other expenses | 1,400 | 2,210 | 2,006 | 2,418 |
| Total expenses | 20,419 | 30,659 | 29,242 | 25,889 |
| **Increase (decrease) in unrestricted net assets** | **(789)** | **313** | **(1,680)** | **6,617** |
| Unrestricted net assets, beginning of year | 8,735 | 8,422 | 10,102 | 3,485 |
| Unrestricted net assets, end of year | $ 7,946 | $ 8,735 | $ 8,422 | $ 10,102 |

**HOPE Rehabilitiation Services, The Foundation for HOPE, and Skills Center, Inc.**
**Consolidated Statements of Financial Position ($000's)**

| | As of Feb. 28 | As of June 30 | | |
|---|---|---|---|---|
| | 2002 | 2001 | 2000 | 1999 |
| **Assets** | (Unaudited) | | | |
| Current Assets: | | | | |
| Cash and cash equivalents | $ 218 | $ 1,487 | $ 1,068 | $ 3,663 |
| Investments | 4,513 | 4,830 | 4,741 | 4,351 |
| Accounts receivable, net | 3,750 | 3,458 | 3,517 | 2,827 |
| Other current assets | 598 | 614 | 440 | 243 |
| Total Current Assets | 9,079 | 10,389 | 9,766 | 11,084 |
| Assets limited as to use | 2,338 | 2,110 | 1,997 | - (e) |
| Property, plant, and equipment, net | 8,876 | 8,577 | 9,305 | 9,512 |
| Other assets | - | 335 | 379 | 448 |
| Total Assets | $ 20,293 | $ 21,411 | $ 21,447 | $ 21,044 |
| **Liabilities & Net Assets** | | | | |
| Liabilities: | | | | |
| Overdraft | $ - | $ 589 | $ 129 | $ - |
| Lines of credit | 2,100 | 1,766 | 1,405 | 200 |
| Accounts payable | 653 | 414 | 740 | 440 |
| Accrued liabilities | 2,199 | 1,854 | 1,842 | 1,645 |
| Current portion of long term debt | 157 | 273 | 289 | 239 |
| Other current liabilities | - | 57 | 61 | - |
| Total current liabilities | 5,109 | 4,953 | 4,466 | 2,524 |
| Bonds payable | 5,410 | 5,410 | 5,550 | 5,675 |
| Loan payable | 453 | 541 | 1,134 | 1,084 |
| Other liabilities | 5 | 403 | 396 | 400 |
| Total Liabilities | 10,977 | 11,307 | 11,546 | 9,683 |
| Unrestricted net assets | 7,946 | 8,735 | 8,421 | 10,102 |
| Temporarily restricted net assets | 308 | 307 | 418 | 198 |
| Permanently restricted net assets | 1,062 | 1,062 | 1,061 | 1,061 |
| **Total Liabilities & Net Assets** | $ 20,293 | $ 21,411 | $ 21,446 | $ 21,044 |

| **Financial Ratios:** | **Proforma** (a) | | | |
|---|---|---|---|---|
| Debt Service Coverage (x) (b) | **1.33** | **1.18** | **(0.42)** | **0.29** |
| Debt/Unrestricted Net Assets (x) | **0.71** | **0.71** | **0.83** | **0.69** |
| Margin (%) | | **0.94%** (c) | **-5.65%** | **19.19%** (d) |
| Current Ratio (x) | | **2.10** | **2.19** | **4.39** (e) |

(a) Recalculates June 2001 results to include the impact of this proposed financing.
(b) Debt service coverage for fiscal 2001 and proforma 2001 would be 0.85x and 0.90x respectively if both short-term and long-term interest expense are included in the calculation. Bond covenants provide for total interest expense to be included in the numerator but only long-term debt to be included in the denominator.
Credit is given for unrealized losses. The debt service coverage ratio specified by the existing bond covenants differs from the staff report figures presented above which are based on the increase in unrestricted net assets (vs. total net assets) and uses current year debt service (vs. maximum aggregate annual debt service).
(c) This margin would be -1.48% if non-operating, one-time sources of revenue are not included.
(d) This margin would be -2.41% if non-operating, one-time sources of revenue are not included
(e) "Assets limited as to use" was not reported as a separate item prior to 2000.

**Financial Discussion:**

**Hope continues to experience unprofitable operations, resulting in inadequate debt coverage. However, the organization draws strength from community support and diversity of revenue.**

Excluding from revenue one-time real estate transactions, Hope has lost money in each year of our review period. This was most pronounced in fiscal 2000, with a negative margin of over 5% as expenses, particularly salaries and purchased services, outpaced the growth in revenues.

A contributing factor to these losses was significant occupancy and personnel costs related to the start-up of a worksite which employed its clients, started in conjunction with a local employer. This project was not fruitful and was wound-down during 2001.

Hope reduced its losses in fiscal 2001, due to a slowing in personnel and other expenses and a substantial increase in governmental funding.

However, interim data indicates that the unprofitable trend continues, with reduced revenues producing a negative margin of approximately 4% (although there is a substantial amount in temporarily restricted net assets that has not yet been released from restrictions). Overall revenue appears to have declined significantly, primarily from a drop in contracted services with local employers. There have been significant job losses in the Silicon Valley area which have rippled through to the low-tech and service jobs typically held by clients. This has also impacted Hope's government reimbursements, much of which is for vocational training.

However, Hope derives strength from not being overly dependent on one revenue source and donations of cash, goods, and services have helped offset this decline. There is even diversity within government revenues (which comprise approximately half of total revenues), with funding for a number of different services from a number of different governmental agencies.

Excluding extraordinary revenues, Hope's debt service coverage has been inadequate in each of the last three years.

**Although Hope continues to rely on short-term financing, its balance sheet is strong.**

Although it is highly liquid, with a current ratio in excess of 2.0x, and considerable balances of cash and unrestricted investments, Hope has shown bank overdrafts and made substantial draws on its lines of credit.

While debt service coverage (excluding extraordinary items) has been weak, Hope has been able to draw upon its substantial unrestricted net asset balance. This resulted largely from a one-time real estate transaction in 1999, causing net assets to nearly triple. Hope had a long-term lease on the land (for a nominal amount) for one of its facilities as well as for undeveloped land intended for possible expansion. Hope and the State both agreed to lease a portion of the land to a developer of low cost housing, with each realizing in excess of $4 million upon receipt of prepayments of the new lease. In addition, Hope purchased 3 acres of the land from the State for $1, recording the fair market value of the property of approximately  $3 million as an increase in net assets.

**This refunding is one of several cost saving measures Hope is undertaking to return to profitability.**

Hope adopted a deficit reduction plan in February 2002, outlining numerous steps to reduce expenses by the end of April 2002, including reductions in personnel and increased fees for contracted services, with an estimated yearly impact of nearly $1,500,000.  This proposed refunding is part of that plan.  In addition, this month Hope announced further layoffs and salary reductions expected to save another $720,000 annually.

Hope has already eliminated 12.5 full-time equivalent employees, expected to produce a yearly savings of $810,000.  With the full implementation of the plan, Hope projects that it will begin breaking-even by July 2002.

With this proposed refunding, Hope will achieve a cost savings of approximately $70,000 per year, which will improve their debt service coverage ratio slightly, to a proforma 1.33x (based on June 30, 2001 income), which would be in excess of the coverage ratio called for in the Authority's guidelines.

## III. BACKGROUND:

Hope's mission is to provide services for people with developmental and other disabilities. Hope provides its services through programs run at fifteen operating centers, eight of which are located in Santa Clara County, six in Monterey County and one in San Benito County. Hope owns four of the facilities and leases the remaining facilities.

Hope's services include adult vocational and prevocational training, job development and placement services, supported living services, mobility training, psychotherapy, early intervention counseling and other services for parents of developmentally disabled children from birth to age three.  In addition, Hope provides specialized training in independent living and other knowledge and skill areas for individuals with severe/profound retardation and multiple disabilities.

Hope Rehabilitation Services, Inc. ("Hope") was established in 1952 by a small group of parents with mentally retarded children.  Founded under the name Hope for Retarded Children and Adults, Hope diversified to meet the needs of its disabled client population that were not otherwise being met.

Related Foundation

In 1979, the Hope established The Foundation for Hope (the "Foundation"), a separately incorporated nonprofit corporation whose mission is to help support Hope's activities, in the form of planned giving, endowments and major capital campaigns.  The Foundation will be a co-obligor on the Series 2002 bonds.

Affiliation Agreement

In 1998, Hope entered into an affiliation agreement with Skills Center, Inc. ("Skills"), a private nonprofit public benefit corporation, wherein Hope became the sole corporate member of Skills. No consideration was exchanged in this affiliation. Skills will be a co-obligor on the Series 2002 bonds.

Service Area and Competition:

Hope's service area is primarily Santa Clara County, California. Hope has one small facility and program in San Benito County and has six small facilities in Monterey County.

The population of the primary service area, Santa Clara County, increased from 1,295,071 in 1980 to 1,682,585 as of 2000, representing an average annual growth rate of 1.4 percent.

Hope is the largest and most comprehensive public provider of mental health and rehabilitation services to individuals with developmental disabilities in the San Francisco Bay Area. Although there currently exist no mental health care or rehabilitation service providers similar in scope to the Hope in its service area, there are several facilities in the area that offer one or more of the services that are offered by Hope.

Licenses and Contracts:

Hope's programs are licensed as adult day care and community care facilities by the Community Care Licensing Division of the State of California Department of Social Services and/or are accredited by the Commission on Accreditation of Rehabilitation Facilities. Hope is also certified to provide Medi-Cal services by the State Department of Health Services.

Approximately half of the Hope's total revenue is earned through contracts, paid on a per capita basis, with the Department of Rehabilitation and the Department of Developmental Services (acting through regional centers) to provide life skills and vocational training.

Hope receives County funding (through Medi-Cal and the Short-Doyle programs) to provide psychotherapeutic and counseling services to developmentally disabled County residents and their families. Under contracts with private business, Hope clients provide services including janitorial, groundskeeping, assembly and packaging services.

## IV. UTILIZATION STATISTICS:

**Number of Clients Served**

| | Fiscal Year Ended June 30, | | |
|---|---|---|---|
| Type of Program | 2001 | 2000 | 1999 |
| Employment and Training | 1,441 | 1,292 | 1,201 |
| Developmental activities | 371 | 334 | 349 |
| Children's services | 220 | 220 | 139 |
| Independent and Supported Living | 205 | 58 | 108 |
| Mental Health | 582 | 430 | 275 |
| Senior Activity Center | 68 | 68 | 72 |
| Entrepreneurial Center | 35 | 20 | 5 |
| Totals | 2,922 | 2,422 | 2,149 |

**Sources of Operating Revenues**

| | Percentage of Total Revenues for Fiscal Year Ended June 30 | | |
|---|---|---|---|
| | 2001 | 2000 | 1999 |
| **Public Funds**: | | | |
| California Department of Rehabilitation | 28% | 28% | 28% |
| Regional Centers/Dept.of Developmental Svcs. | 20 | 20 | 20 |
| County Mental Health/Medi-Cal | 3 | 3 | 3 |
| Miscellaneous | 4 | 3 | 3 |
| | 55 | 54 | 54 |
| **Private Funds**: | | | |
| Work for Industry | 24 | 26 | 26 |
| Salvage solicitation/Collection | 7 | 8 | 8 |
| Donations/Memberships/Special Events | 11 | 10 | 10 |
| Miscellaneous | 3 | 2 | 2 |
| TOTAL | 100% | 100% | 100% |

**V. SECTION 15438.5 OF THE ACT (Savings Pass Through):** According to management, the savings resulting from the proposed bond issue will be passed on to the consuming public through lower rates for its services and will enhance their ability to provide care for individuals who would otherwise be unable to pay.

**VI. SECTION 15459.1 (b) OF THE ACT (Community Service Requirement):** The applicant has submitted the Certificate and Agreement Regarding Community Service Obligation with this application as required by the Act.

**VIII. OUTSTANDING DEBT**:

As of December 31, 2001, the outstanding debt issued through the Authority for Hope Rehabilitation Services was $5,415,000. Following the proposed financing, Hope will have outstanding approximately $6,000,000 of Authority debt. The composition of Hope's total long-term debt structure is as follows:

| **Date Issued:** | **Original Amount** | **Amount Outstanding As of 12/31/01** | **Estimated Amount Outstanding after Proposed Financing** |
|---|---|---|---|
| ***Existing Authority Debt:*** | | | |
| Hope 1990 Series A | $6,500,000 | $5,415,000 | $ 0 |
| ***Proposed Authority Debt*** | | | |
| Hope 2002 Series A | | | 6,000,000 |
| ***Total Authority Debt*** | | 5,415,000 | 6,000,000 |
| ***Other Debt*** | | 625,000 | 625,000 |
| Totals | | $6,040,000 | $6,625,000 |

## VII. LEGAL REVIEW:

Staff has reviewed the Applicant's responses to the questions contained in the Legal Status portion of the Application. No information was disclosed to question the financial viability or legal integrity of this applicant.

**IX. STAFF RECOMMENDATION:** Staff recommends the Authority approve a Resolution in an amount not to exceed $6,000,000 for Hope Rehabilitation Services subject to a final insurance commitment from Cal-Mortgage, producing a rating in the "A" category.