CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY
VALLEY PRESBYTERIAN HOSPITAL ("VPH")
Series 1997
August 26, 2004

First Amendment to Loan Agreement

ISSUE: Three technical events of default have occurred in a bond issued by the Authority on behalf of VPH. MBIA Insurance Corporation ("MBIA"), the bond insurer, has indicated it will waive noncompliance on the condition that certain amendments are made to the provisions of the loan agreement, including taking a deed of trust on all of VPH's real property as well as strengthening existing covenants. The key provisions of this amendment are summarized in Exhibit A.

Events of default:

- Debt service coverage - In the existing loan agreement, VPH covenanted to produce Net Income Available for Debt Service in each fiscal year equal to at least 1.1 times Maximum Aggregate Annual Debt Service. VPH did not produce the required net income for the fiscal year ended October 31, 2003. Also, it was recently determined that insufficient net income had been produced in each of the years ended October 31, 2002, 2000, and 1999 as certain ineligible grant proceeds had been included in the Net Income calculation.

- Days cash on hand - VPH covenanted to maintain 65 days cash on hand. "Days cash" is the amount of cash equivalent to the fiscal year's operating expenses (less depreciation and bad debt expense) divided by the number of calendar days in the year. VPH did not maintain the minimum days cash at the most recent test measurement date of April 30, 2004. According to VPH management, the ability to meet this covenant is affected by the timing of Disproportionate Share Hospital ("DSH") payments from the State of California. The most recent DSH payment was received following the April 30, 2004 test date.

- Financial statements - VPH has not submitted its audited financial statements for the 2003 fiscal year (although a draft of the 2003 audited financial statements has been prepared). VPH and their auditors have not released these financial statements until they can confirm that the Authority and MBIA will grant waivers due to the material effect that unwaived defaults would have on the statements**.**

BACKGROUND: The Authority issued its California Health Facilities Financing Authority Insured Hospital Refunding Revenue Bonds (Valley Presbyterian Hospital), Series 1997 (the "Bonds") in the original aggregate amount of $55,155,000. The amount outstanding as of June 30, 2004 is $34,160,000. The Bonds were issued pursuant to an Indenture between the Authority and First Trust of California, N.A., succeeded by U.S. Bank N.A., (the "Trustee"), and are insured by MBIA (rated AAA by S&P). All payments of principal and interest to date have been fully and timely made.

Hospital management has informed the Authority, the Trustee, and MBIA that it was in technical default of the covenants detailed above. Since at least November 2003, the Hospital has employed the Camden Group, a management consulting firm, to improve its operating performance. MBIA indicated that it will consent to a waiver of these events of default contingent upon the additional covenants included in the First Amendment to the Loan Agreement

STAFF RECOMMENDATION: Staff recommends the Authority approve a resolution authorizing the First Amendment to the Loan Agreement for the Authority's Valley Presbyterian Hospital, Series 1997 bonds.

Exhibit A

Key new provisions of the First Amendment include:

- VPH will be required to execute a deed of trust on substantially all of its real estate, including the hospital campus, parking lot, etc. There will be no condition for the release of this lien. Currently, the loan agreement calls for a deed of trust to be recorded on the hospital campus, parking lot, etc., if the debt service coverage ratio falls below 1.1 times. Also, under the current loan agreement, the deed of trust is to be released if this ratio exceeds 1.1 times for two consecutive years.

- A loan default would occur if yearly net income available for debt service is less than 1.0 times maximum aggregate annual debt service. Currently, VPH covenants to produce net income equal to at least 1.1 times such debt service and to employ an independent consultant if this ratio is not maintained.

- VPH will be required to maintain at least 65 days cash on hand, and provide evidence of this at the October 31 fiscal year-end and at April 30. Currently, if there is insufficient cash at these periods, there will not be an event of default if 32.5 days cash is transferred to a trustee-controlled collateral account. In addition, "days cash" will be redefined so that the numerator will be limited to only unrestricted cash and investments and the denominator will be expanded to operating expenses less depreciation. Investments will be further adjusted to exclude the dollar amount of short-term borrowings.

- Certain defined Permitted Encumbrances will be eliminated. Currently VPH can create any lien that does not exceed 20% of its properties, can create a lien that is limited to properties not securing its Authority debt, and can create liens on up to 35% of its accounts receivables. Several other types of encumbrances will continue to be permitted, including liens securing parity debt.

- A new covenant would require that VPH not lease any of its properties for any purpose other than those that are customarily used by hospitals.