

CALIFORNIA HEALTH FACILITIES FINANCING AUTHORITY

STAFF SUMMARY AND RECOMMENDATION

Request for Exceptions to Certain Financial Covenants in the Authority's Bond Issuance Guidelines

Kaiser Permanente ("Kaiser")
Oakland, California

Resolution No. 2006-05

March 23, 2006

PURPOSE OF RESOLUTUON: Kaiser is requesting the Authority approve a Resolution granting exceptions to certain financial covenants in the bond issuance guidelines, in particular, elimination of the Gross Revenue Pledge and the requirement to maintain appropriate rates and charges to maintain a minimum coverage ratio of at least 1.25 times maximum annual debt service ("MADS"). This also eliminates the requirement to maintain minimum 1.25 times coverage to incur additional debt. Kaiser will comply with all other currently published bond issuance guidelines.

DISCUSSION: Gross Revenue Pledge. Kaiser's revenues are different and more secure than other borrowers of the Authority. Kaiser's patients are Kaiser enrollees in one of its Health Plan Organizations, that contract with Kaiser Hospitals to provide hospital services and, in turn, pay Kaiser Hospitals the amount required to satisfy ordinary operating expenses, the cost of arranging services and pay debt service as well as fund capital requirements for the replacement and expansion of facilities. With this membership structure, Kaiser receives revenue upfront, before service is rendered. This is unlike a typical healthcare provider that collects payments after services have been performed, thus minimizing volatility in Kaiser's revenue stream.

Maximum Annual Debt Service. Kaiser has historically issued non-amortizing bullet maturities, which makes the application of a typical MADS coverage covenant misleading. This structure is similar to a balloon payment where interest only payments are required until the maturity of the bonds, typically up to 40 years. However, with a bullet maturity and a large principal payment due, this ratio may drop below the minimum requirement possibly triggering a technical event of default. Kaiser sets aside cash and securities to meet its principal payment obligations for bullet maturities which is not included in the MADS calculation. Kaiser has indicated its willingness to provide the Authority its MADS coverage calculation upon request. The Authority anticipates monitoring Kaiser's MADS coverage ratio on an annual basis to determine if it meets the minimum requirement. Additionally, when Kaiser experienced operating losses in the late 1990's, the MADS coverage ratio continued to exceed the minimum coverage. Should the MADS calculation drop below the minimum requirement, the Authority will determine if this is a one-year event or a developing trend. In the case of a developing trend, the Authority will work with Kaiser to review its options to increase the MADS coverage.

Rationale for approving exceptions. Based on the financial strength of Kaiser's balance sheet with \$10.8 billion in net equity, continued strong operating performance, the requirement to maintain certain levels of reserves to continue providing healthcare to its membership, its unique revenue stream and an A+/A rating by Standard & Poor's/Fitch, staff is recommending approval to these exceptions. Moreover, Kaiser has not provided a Gross Revenue Pledge nor a MADS

covenant on any of its current \$2.6 billion debt portfolio, including revenue bonds previously issued by the Authority. Lastly, by denying this exception, it would impact Kaiser's outstanding debt in the secondary market. Kaiser requires consistency in its bond covenants in order for the public to continue purchasing its bonds. The price of buying and selling existing securities would be affected with different covenants for future debt. To amend existing bond documents for parity purposes would be a complex and cumbersome process.

FINANCING PROPOSAL: Kaiser plans to invest approximately \$16 billion in projects from 2006-2012 throughout California, including new medical office buildings, construction of replacement hospitals to meet seismic requirements and expansion of existing facilities. Kaiser is currently evaluating various financing options for 2006 to issue up to \$1.5 billion in revenue bonds for new money projects in Northern and Southern California. This request for exceptions is the first in a two-step approval process. Kaiser anticipates returning to the Authority in April 2006 with the financing application that will provide additional detail regarding the proposed construction projects, financial status and structure of the financing. See Exhibit A for the anticipated project listing for 2006.

FINANCIAL STATUS: Kaiser's operating revenues are in a positive trend and have grown from \$28 billion in 2004 to \$31.1 billion in 2005, generating strong operating margins of 5.7% and 3.2% for the years 2004 and 2005, respectively. The balance sheet also improved with net equity increasing from \$9.85 billion in 2004 to \$10.81 billion in 2005. Total debt to net equity is considered low at 0.24x for 2005. Total cash and investments is approximately \$10.8 billion, equating to 134.8 days cash on hand and 4.1x cash to debt. Kaiser currently maintains long-term ratings of A+/A by S&P and Fitch, respectively, as well as short-term ratings of A-1 and F1 by S&P and Fitch, respectively.

BACKGROUND: Kaiser Permanente is the largest non-profit health plan in the United States, serving 8.4 million members in 9 states and the District of Columbia. Kaiser is comprised of an integrated health delivery system and Health Plan Organizations. These Health Plan Organizations are non-profit corporations that enter into membership contracts with individuals and groups to arrange covered medical services on a predominantly prepaid basis. Listed below is a geographic breakdown of Kaiser's membership as of December 2005:

	Number of Members as of Dec 2005	Percentag e of Total Members
Northern California	3,236,785	38.3%
Southern California	3,125,072	37.0%
Hawaii	226,653	2.7%
Mid-Atlantic States	500,194	5.9%
Northwest	477,929	5.7%
Colorado	453,245	5.4%
Georgia	279,394	3.3%
Ohio	145,962	1.7%
Total	<u>8,445,234</u>	<u>100.0%</u>

COMMUNITY BENEFIT: See Exhibit B for a description of Kaiser's community benefit programs.

RECOMMENDATION: Due to Kaiser's strong financial condition and business model and protections provided by other financial covenants, it is staff's conclusion that the Authority will be no less protected, and likely more protected in connection with Kaiser financings as compared to other borrowers. Therefore, staff recommends the Authority approve exceptions to certain financial covenants in the Authority's currently published bond issuance guidelines with respect to revenue bonds issued in 2006 for the benefit of Kaiser Permanente: 1) Gross Revenue Pledge and 2) Reporting requirement to maintain appropriate rates and charges and the requirement to maintain a minimum coverage ratio of at least 1.25 times maximum annual debt service (including the requirement to maintain minimum 1.25 times coverage to incur additional debt). Future requests by Kaiser Permanente for exceptions to the Authority's bond issuance guidelines will be considered on a case-by-case basis with each application for financing, taking into account Kaiser's financial strength and business plan to ensure that, in no case, the level of protection drops below the full protection needed to ensure the Authority's and bondholders interests.

Kaiser Permanente
Anticipated Project List

Panorama City Replacement Hospital

This Project includes building a new 218-bed replacement hospital (plus an option to build an 8 bassinet Neonatal Intensive Care Unit (NICU)) on the existing Panorama City Medical Center (PCMC) campus. This plan provides SB1953-compliant inpatient services for the east San Fernando Valley Kaiser Permanente membership. The project is in construction.

Los Angeles Medical Center

This Project includes building a new 464-bed replacement hospital on the existing Los Angeles Medical Center campus to comply with SB1953 seismic regulations. LAMC provides general acute care to approximately 200,000 members within a thirty-minute drive time of the facility and specialized tertiary and quaternary services (cardiac surgery, neurosurgery, pediatric surgery, radiation therapy and complex/rare medical care) to the members residing in the Greater Los Angeles area. The project is in construction.

West LA Medical Center

The West Los Angeles Tower Addition (178,000 sq. ft.) replacement project provides a seismically compliant facility, as required by SB 1953 and approved by the Federal Emergency Management Agency. In addition, a parking structure, upgrades to the central plant, remodels to the existing compliant South Tower and relocations of displaced outpatient departments are necessary. To accommodate the parking structure, the Venice B building will be demolished and the occupants will be relocated. The project is in construction.

South Bay Replacement Hospital – Vermont Pavilion

The 112,480 square feet building will house Labor & Delivery, Post Partum, Pediatric and Neonatal Intensive Care Unit (NICU) inpatient areas as well as Perioperative functions that will address capacity demand through 2014. In addition, two other projects support the new building - a parking structure and upgrades to the Central Plant. The project is in construction.

Hayward Replacement Hospital

The Project includes the purchase of 63 acres of land in the San Leandro Marina area. The planned campus will provide a full range of medical services to residents of the Hayward and South Oakland geographical area. The services that will be provided will include a 298-bed hospital and a 182-Provider Office (PO) Medical Office Building with an Ambulatory Surgery Center (ASC).

Modesto Hospital and Medical Office Building

This Project is being constructed on 49 acres in Salida / North Modesto. The Project includes the construction of a 224-bed hospital and an 80-Provider Office (PO) Medical Office Building.

Interstate 580 Land Purchase

This Project will include the purchase of approximately 50 acres of land in the Diablo area at the I-580/I-680 interchange. The cost also includes the costs of development and entitlements. This Project will provide land for future development as membership grows in the area.

Oakland Medical Center

The replacement of the Oakland Medical Center is a complex, 3-phased strategy. This project is related to Phase 1 and includes building a Medical Office Building (MOB) (50-provider office) parking structure (728 car), and internalizing Radiation Therapy on Broadway Avenue near Oakland Medical Center (OMC) by 2008 for required relocation of services and parking so that OMC can be rebuilt on the MacArthur Broadway (MB) Center site in time for compliance with SB 1953 seismic legislation.

Pleasanton Information Technology Campus

Kaiser has recently purchased a portion of the former People Soft campus in Pleasanton. This space will accommodate up to 1600 IT employees of Hospitals.

Kaiser Permanente Community Benefit

Kaiser Foundation Hospitals, as part of Kaiser Permanente, is committed to improving the health of our communities and to increasing access to health care services for vulnerable populations through a broad range of community benefits. KFH provides a broad level of community benefit aimed at:

- Strengthening the safety net,
- Providing health care services to the uninsured and underinsured,
- Participation in public programs for vulnerable populations, and
- Providing subsidized coverage to low-income persons who would otherwise be uninsured.

In 2004, KFH provided a total of \$366.3 million in community benefit in California (this amount excludes community benefit provided by Kaiser Foundation Health Plan). For example:

- Kaiser Permanente's Dues Subsidy Program provides a medical home for low-income, uninsured persons who would not otherwise have coverage. Kaiser Permanente's Dues Subsidy Program has two components:
 - Child Health Plan ("CHP") provides subsidized coverage to children up to 18 years of age who do not qualify for publicly-financed or employer-sponsored programs and have no other coverage. CHP is also available to children of low-income families who do not qualify for coverage because of their immigration status. As of September 30, 2005, CHP has approximately 27,600 enrolled persons.
 - "STEPS" is offered to Kaiser Permanente low-income Californians who would not otherwise be eligible for sponsored coverage. STEPS has approximately 16,500 enrolled persons.
- KFH is partnering with the California Association of Public Hospitals' Safety Net Institute to develop a multifaceted strategy to increase the potential of public hospitals and health systems by focusing on chronic care management quality improvements. Active partnership with safety net partners enables KFH to cultivate community-wide approaches to addressing disparities, including the development of patient-centered, community-focused, evidence-based chronic care management strategies.
- KFH contributed more than \$7 million through its Community Clinic Partners Program to support over 150 community clinics, health centers and associations serving vulnerable populations. The Community Clinic Partners Program was created in response to the growing number of medically indigent California residents. KFH developed partnerships with community clinics and clinic associations throughout the state to increase their service capacity and improve quality of care by providing financial, human, and technical resources. Additionally in 2004, KFH responded to community clinics and clinic networks wanting to improve their quality and access for underserved populations with an emphasis on those with chronic conditions. In addition to funding for capacity-building, a menu of training and technical assistance around chronic conditions management enabled clinics and their networks to improve their systems of care.

- In 2004, KFH provided approximately \$48.3 million in charity care in California. This amount does not include any contractual shortfalls resulting from participation in public programs such as Medi-Cal. KFH defines and measures charity care in a manner consistent with the recommendations of the Office of Statewide Health Planning and Development.
- Operation Access, co-founded by a Permanente physician, provides free surgical care for the uninsured in several Bay Area counties. KFH - San Francisco was the pilot site for the program and, as of 2004, seven Northern California Region facilities participate. KFH's participation was instrumental in recruiting other community hospitals and clinics, and expanding the network of medical volunteers. In 2004, one hundred twenty-two Operation Access surgeries were performed at Northern California KFH facilities. A nonprofit corporation, Operation Access is the only organization of its kind to offer low-risk elective surgeries to the uninsured in the United States. The most common type of surgery performed is for inguinal hernia, which represents about 34% of the surgeries performed by Operation Access. A hernia often keeps men from obtaining a job. Because it is a pre-existing condition, it prevents the person from obtaining coverage. These surgeries significantly improve the quality of the patient's life.
- KFH's emerging Community Health Initiatives (CHI) strategy is based on a growing evidence-base and Kaiser Permanente's experience with community health partnerships.

The CHI strategy seeks to create a demonstrable impact on population-level health outcomes through intensive, place-based interventions and multi-sector partnerships that promote environmental and policy change. KFH's CHI strategy holds that major improvements in community health can be brought about by sustained, targeted and comprehensive efforts, featuring the following characteristics:

- A defined geographic focus, somewhere between the size of a neighborhood and a county, which allows for improved targeting of resources and deeper reach to those in need of health services.
- A broad definition of health and a focus on issues resonant with both assessed and expressed community needs.
- Multi-level interventions, including those addressing the environmental and community conditions that have a powerful influence on health behavior.
- Partnerships with organizations from multiple sectors - a reflection of the complexity and interconnectedness of effective health improvement strategies.
- A commitment to evidence-based care, community-level health interventions, and measurable outcomes and accountabilities.
- Long-term commitments in the 7-10 year time frame, in recognition of the sustained effort that is required to bring about meaningful changes in community health.

Supported by \$16.5 million in KFH funding, and an additional \$28 million in foundation and public funds leveraged by these resources, Kaiser Permanente developed various strategies to begin implementing a number of CHIs, including developing partnerships with local and regional foundations, creating targeted grant-making programs to support community-based organizations promoting healthy eating and active living, and collaborating with public health departments working on the federal "Steps to a Healthier U.S." initiative and similar efforts to address the national epidemic of obesity and related health problems.

- Participation in public programs sponsored by California for low-income persons. As of September 2005, Kaiser Permanente membership figures for these programs were:

Medi-Cal	109,167
Healthy Families Program	85,274
MRMIP and MRMIP Graduate	5,280
Access for Infants and Mothers (AIM)	1,153

In 2004, KFH subsidized care for Medi-Cal members in an amount equal to \$70.9 million and for Healthy Families members in an amount equal to approximately \$14.6 million. In addition, KFH subsidized Medi-Cal beneficiaries who were not Kaiser Permanente members in an amount equal to \$89.9 million in 2004.

Kaiser Permanente helped develop and enact the MRMIP graduate program. Our Child Health Plan was a model for the development of the federal State Child Health Insurance Program.

- For over 35 years, KFH's Watts Counseling and Learning Center (WCLC) has been a valuable community resource for low-income, inner-city families in South Central Los Angeles. WCLC provides mental health and counseling services, assistance to children with learning disabilities, and pre-employment training to high school youth. In addition, WCLC operates several programs including: a state-licensed preschool program, a summer day camp, "Kids Can Cope" support groups (for children whose siblings or parents have cancer), scholarships to high school and postsecondary students, and training for graduate social work interns from local universities.
- KFH sponsors an Educational Theatre Program (ETP), a unique community benefit that helps to improve the health of our communities and prevent expensive emergency department use and hospitalization. These award-winning programs bring health education to thousands of school children each year. In Northern and Southern California, KFH is currently presenting ten productions: *Zip's Great Day* (two simultaneously touring productions promoting nutrition, exercise, safety and self esteem for grades K-3); *PEACE Signs* (two simultaneously touring conflict resolution/violence prevention programs for grades 3-6 and their families); *Nightmare on Puberty St.* (two simultaneously touring productions dealing with early adolescent health issues for middle school student); *Secrets* (two simultaneously touring productions promoting HIV/STI prevention for high school students); *The Amazing Food Detective*, a bilingual nutrition promotion play for elementary school students and *Arrrrsthma*, an asthma awareness play, also for elementary school students. Each program presents important age-appropriate health education information to students in a format that is entertaining and engaging. In 2004, KFH spent \$4.3 million on 800 ETP performances that reached approximately 450,550 children and their families in Northern and Southern California.