# FIRST RIVER ADVISORY L.L.C.

233 SOUTH 6TH STREET, SUITE 302
PHILADELPHIA, PENNSYLVANIA 19106-3750

OFFICE TELEPHONE – (215) 568-9303
*SHELLEY J. ARONSON* ➤ aronson@firstriver.com
*ANNE S. MORSE* ➤ morse@firstriver.com

# *CLIENT SPOTLIGHT*

## OAKLAWN HOSPITAL

**$8,000,000**
**County of Calhoun Hospital Finance Authority**
**Hospital Revenue Bonds, Series 2005**
**December 2005**

**$37,800,000**
**Michigan State Hospital Finance Authority**
**Hospital Revenue Refunding Bonds, Series 2006**
**Periodic Auction Reset Securities (PARS℠)**
**April 2006**

**$36,700,000**
**Michigan State Hospital Finance Authority**
**Hospital Revenue Refunding Bonds, Series 2006**
**(remarketing and conversion from PARS℠ to VRDBs)**
**October 2007**

**$8,000,000**
**County of Calhoun Hospital Finance Authority**
**Hospital Revenue Bonds, Series 2008**
**October 2008**

**Termination of Defaulted Interest Rate Swap**
**December 2008**

**Negotiation of New Interest Rate Swap**
**April 2009**

**$30,000,000**
**County of Calhoun Hospital Finance Authority**
**Revenue Refunding Bonds, Series 2009A and 2009B**
**December 2009**

**$2,650,000**
**2009 Conventional Term Loans**
**December 2009**

**$30,000,000**
**County of Calhoun Hospital Finance Authority**
**Revenue Bonds, Series 2010A, plus Associated Interest Rate Swap**
**December 2010**

**$8,000,000**
**2010 Conventional Term Loan, plus Associated Interest Rate Swap**
**December 2010**

**Restructuring of 2009 Interest Rate Swap**
**September 2011**

**$63,515,000**
**County of Calhoun Hospital Finance Authority**
**Hospital Revenue and Refunding Bonds, Series 2016A**
**November 2016**

First River Advisory's relationship with Oaklawn Hospital, which commenced in 2004, has encompassed both the issuance of new debt and the management of outstanding debt. Several situations which Oaklawn has encountered were unprecedented. First River Advisory consistently met these challenges by fashioning cost-effective solutions that addressed a myriad of circumstances.

In many respects, Oaklawn is the epitome of what a community hospital should be in these changing times. Since being threatened with closure by state authorities in the 1970s, Oaklawn has evolved from a self-described "backwater band-aid station" to a financially stable organization featuring clinical capabilities that rival its larger competitors. Oaklawn is a progressive and growing organization whose hallmarks are quality and teamwork. Oaklawn consistently achieves top-drawer quality metrics and records excellent satisfaction scores among patients, employees and affiliated physicians.

Oaklawn has repeatedly demonstrated its ability to "think outside the box" with respect to approaches to capital financing and debt management. Oaklawn has taken calculated risks and utilized most of the advanced financing techniques available to hospitals, some of which are rarely considered by smaller community hospitals. Though Oaklawn has experienced certain pitfalls, it has proven its resilience through speedy and decisive corrective action.

When First River Advisory's engagement as Oaklawn's financial advisor commenced in 2004, Oaklawn had issued a small amount of debt only once, using a straightforward approach.

Aside from this transaction, neither the governing board (the Board) nor the chief executive officer had any experience with capital financing. Oaklawn's first-time chief financial officer at the time possessed extensive experience in other aspects of hospital financial management, but had been exposed to capital financing only tangentially. Among First River Advisory's activities during the early stages of the engagement were various forms of educational sessions for both management and Board. Since then, First River Advisory has managed several capital formation initiatives and debt management tasks, with the most recent milestone having been Oaklawn's successful issuance of Series 2016 Refunding Bonds.

First River Advisory's relationship with Oaklawn has been its most comprehensive by far. The situations described herein demonstrate first-hand First River Advisory's hallmark qualities from which other health care organizations can benefit:

- comprehensive, "leave no stone unturned" approach;
- creative thinking and innovative solutions;
- appreciation for and detailed analysis of risk factors;
- breadth, depth, organization, readability and "user-friendliness" of clients' credit information that attracts investors and lenders;
- bold negotiation of terms, conditions and covenants;
- conveyance of complex information to executives and Board members and definition of options and alternatives in a manner that promotes decision-making;
- effective interface with project development teams;
- assertive leadership of financing teams and consensus-building among diverse members;
- demander of accountability among other financing team members and not afraid to discontinue participation of laggards; and
- meticulous attention to detail.

According to Gregg Beeg, Oaklawn's Interim CEO and former CFO, *when I came aboard, I quickly learned that First River Advisory is an outstanding resource and had become Oaklawn's "institutional memory" with respect to capital formation and debt management. Before too long, we needed to address over $30 million of upcoming balloon payments, which became an even more pressing issue when our bank notified us that they did not plan to renew. First River Advisory's*

*ability to "see around corners" identified a tremendous opportunity to "de-risk" our balance sheet. First River Advisory led us through the process in an orderly and efficient manner so that we could take advantage of highly favorable market conditions. Three of First River Advisory's recommendations were particularly spot-on in promoting the success of our $63½ million bond issue. Shelley Aronson of First River Advisory was indefatigable, spending countless hours both orchestrating the financing team and completing his own tasks. I found that having an experienced financial advisor who's clearly on your side is indispensable, because for those of us who are rarely involved in capital financing "you don't know what you don't know."*

## SETTING THE STAGE

The original premise for First River Advisory's engagement was Oaklawn's plan for an ambitious expansion and renovation project (the 2006 Project). In addition to this project, Oaklawn had another $5-plus million renovation project underway, as well as a substantial amount of routine capital expenditures. Although financial reserves were growing, they would not be sufficient to fund all of these projects without compromising Oaklawn's liquidity. To address the question of debt capacity, Oaklawn management integrated various capital financing scenarios developed by First River Advisory into its forecasting model in order to achieve a balance between profitability, liquidity and leverage. This financial modeling indicated that approximately $47 million of debt, including the $9 million which would remain outstanding at the end of 2005, would represent an optimal level. Because of this substantial increase in debt, it would be crucial for Oaklawn's 2006 Financing Plan to specify one or more debt instruments that would be well-structured, issued in an efficient manner and reduce risks to manageable levels.

First River Advisory postulated that bank products (loans, direct purchases of bonds, letters of credit, etc.) could play a role in viable financing solutions. In order to determine the level of banks' interest, First River Advisory conducted meetings with several banks, including the existing lender which held consent rights with respect to the issuance of additional debt. Two objectives were achieved by the outcome of these exploratory meetings:

- they enabled First River Advisory to estimate the viability of and the pricing, terms and conditions relating to various bank products, essential elements in the analysis of 2006 Financing Plan alternatives; and

- it was determined that the lending appetite among banks other than the existing lender would represent viable alternatives if the existing lender were to threaten to withhold its consent relating to the issuance of additional debt.

First River Advisory has found that such meetings are essential in every engagement because of banks' tendency to vacillate between eagerness and disdain with respect to extending credit to hospitals, especially those on the lower end of the credit quality spectrum.

The benefits of bank products would entail Oaklawn's acceptance of a certain degree of risk, which became a key dimension in the formulation of the 2006 Financing Plan. First River Advisory conducted extensive discussions with Oaklawn's management and Board to determine the organization's risk tolerance. As a result, the 2006 Financing Plan was tailored to this perspective by limiting variable-rate debt to no more than approximately $13 million (of the $47 million total) and the final maturity of such debt to no more than 15 years. First River Advisory maintains that there is no "right" answer to this question, and one which cannot be easily quantified because of its dependency on unpredictable future events. Nevertheless, it remains First River Advisory's responsibility to ensure that its clients make conscious, informed decisions based on data which are available, and with an appreciation for the gaps in knowledge.

## SERIES 2005 BONDS

The implementation of the 2006 Financing Plan commenced in the autumn of 2005 by requesting formal proposals from the banks which were interviewed during the development of the 2006 Financing Plan. Because Oaklawn had no credit history beyond its historic relationship bank, First River Advisory assembled a credit profile consisting of baseline information required for credit decisions. This credit profile, together with a well-defined financing request, attracted aggressive bank proposals. Because proposals by banks to purchase directly "bank-qualified" tax-exempt bonds were generally superior to those proposing to issue letters of credit, time became a critical factor. First River Advisory collaborated with bond counsel to create a local hospital finance authority for the purpose of issuing such "bank-qualified" bonds by the end of 2005. First River Advisory orchestrated the governmental approval process, the bank approval process, Oaklawn's internal approval process and the legal documentation process in a manner that expedited the issuance of the Series 2005 Bonds by the end of the year.

To comply with the 2006 Financing Plan, the final maturity of the variable-rate Series 2005 Bonds was set at 2020, fifteen years from their issuance. Amortization of the Series 2005 Bonds was deferred in order to extend their weighted average maturity (WAM) to a level which approached the composite useful life of the assets financed and refinanced. The bank which purchased the Series 2005 Bonds maintained the right to tender them for purchase at par, but only upon nearly four years' notice. The purchaser also agreed to more modern terms, conditions and covenants that would provide a solid foundation for the issuance of additional debt to finance the 2006 Project shortly thereafter.

## SERIES 2006 BONDS

The issuance of the Series 2005 Bonds represented an intermediate step in the implementation of the 2006 Financing Plan. The principal objective of the 2006 Financing Plan was the establishment of a framework for the financing of the $21.3 million 2006 Project. First River Advisory's engagement was planned to have a long lead time so that Oaklawn would have the benefit of First River Advisory's insight and assistance from a point in time nearly nine months prior

to filing a Certificate of Need (CON) application for the 2006 Project. Over the 19 months of this engagement, First River Advisory was called upon to produce rigorous analyses of the costs, benefits, risks and implementation factors of various alternatives every step of the way.

### PROJECT PLANNING AND CON

First River Advisory believes that its close collaboration with clients' architects, construction managers and other members of project development teams is essential to coordinate projects' budgets and timetables with the development and implementation of financing plans. First River Advisory routinely advises clients that most of the risks associated with project development are within their control, and that alleviating those risks will improve financing terms. In Oaklawn's case, First River Advisory advised on such matters as construction contract terms, payment and performance bonds and builder's risk insurance, and techniques to minimize arbitrage rebate.

First River Advisory defined and analyzed various scenarios so that the capital financing questions on the CON application could be addressed. Because its credibility had been established in connection with previous clients' CON applications, the State CON bureau accepted First River Advisory's letter concerning the availability of financing in lieu of one from a financial institution.

### PLANNING AHEAD

The 2006 Financing Plan called for the issuance of approximately $34 million of long-term, fixed-rate bonds which would commence amortizing after 15 years. First River Advisory observed that Oaklawn's credit characteristics were continuing to improve dramatically, and recommended that this portion of the financing be deferred from January 2006, as originally planned, to April so that the FY2005 audited financial statements could be presented to investors. To "lock in" interest rates associated with highly favorable market conditions, First River Advisory recommended that Oaklawn enter into a fixed-payer "rate-lock" interest rate swap which would terminate on May 1, 2006, beyond the expected closing date of the financing. Once again, First River Advisory analyzed thoroughly and explained in detail the costs, benefits and risks associated with this strategy.

### RATING AND BOND INSURANCE

In January 2006, First River Advisory commenced preparation of a more extensive presentation of credit information which was designed to evolve into "Appendix A" to the Official Statement (OS) relating to the Series 2006 Bonds. The marketability of long-term, fixed-rate bonds specified in the 2006 Financing Plan would be improved if Oaklawn were able to achieve an investment-grade rating. The organization, completeness and readability of the Appendix A, together with First River Advisory's design of the site visit presentation, were meaningful factors in the achievement of this objective.

Concurrently, First River Advisory commenced a dialogue with bond insurers to determine their interest in insuring the Series 2006 Bonds. One such conversation bore fruit, resulting in the issuance by Radian Asset Assurance of a bond insurance policy. Beyond the obvious improvement in the yield of insured Series 2006 Bonds over that of uninsured bonds, having the bond insurance policy opened up other possibilities.

## STRUCTURING THE SERIES 2006 BONDS

Market conditions at the time indicated that yields on synthetic fixed-rate bonds were materially lower than those on natural fixed-rate bonds. First River Advisory confirmed the validity of this observation by applying Oaklawn's facts and circumstances. First River Advisory also analyzed the costs, benefits, risks and implementation factors of auction-rate securities (ARS) compared to insured (not backed by a bank letter of credit) variable-rate demand bonds (VRDBs). While the financial analysis revealed only an immaterial difference, Oaklawn selected the ARS on the basis of less perceived risk and fewer implementation issues. Through a competitive process, a "bulge-bracket" investment banking firm was selected to underwrite the ARS and serve as the ongoing broker-dealer.

The "rate lock" interest rate swap established in 2005 proved to be a wise strategy, for the application of its termination payment of $1,201,000 toward project costs reduced the principal amount of the Series 2006 Bonds to $37.8 million. To achieve a synthetic fixed rate with respect to $32,525,000 of the Series 2006 Bonds, First River Advisory arranged for a new interest rate swap to replace the "rate-lock" swap, which had performed its function admirably. Consistent with the 2006 Financing Plan, the other $5,275,000 of Series 2006 Bonds, amortizing through 2012, was left unhedged as variable-rate ARS. Once again, First River Advisory thoroughly and deliberately explained this advanced technique to Oaklawn's management and Board, especially with respect to the subtle differences in risk factors compared with natural fixed-rate bonds. First River Advisory had pointed out the risks inherent in the ARS structure, yet Oaklawn determined that the probability of those risks becoming realized were low enough, and the rewards great enough, to warrant proceeding. The Series 2006 Bonds represented the Michigan State Hospital Finance Authority's first issuance of Radian-insured bonds, and the first time it had issued ARS for a community hospital. Radian heralded this transaction in its advertising as an example of its capabilities.

## REMARKETING AND CONVERSION OF THE ARS

Interest rates on Oaklawn's Series 2006 ARS had tracked relevant indices closely since their issuance in April 2006 through mid-2007. Suddenly, the interest rate established at the August 14, 2007 auction increased sharply due to the deterioration of Radian's credit quality, largely attributable to a corporate affiliate's exposure to sub-prime residential mortgage loans. First River Advisory and Oaklawn's management swung into action immediately, and determined within a week that the best course of action would be to "wrap" the bond insurance policy with a one-year bank letter of credit (LOC) and convert the ARS to variable rate demand bonds (VRDBs). At its

August 24 meeting, Oaklawn's Board endorsed this plan. Implementation began immediately thereafter with the release of a request for LOC proposals. Speed was essential, as the interest rates on the ARS determined at subsequent auctions increased even further, causing Oaklawn to experience excess interest expense of over $22,000 per week. The LOC wrap and VRDB conversion was completed on October 24, just ten weeks after the pivotal August 14 auction, and represented the first transaction of its type. The novelty of this transaction was cited in *The Bond Buyer*, a leading trade publication (attached).

## Replacement Remarketing Agent

Once converted, weekly interest rates on Oaklawn's Series 2006 VRDBs tracked the SIFMA Municipal Swap Index closely and consistently until April 2009, when the spread increased suddenly from four basis points to 100 basis points. First River Advisory quickly determined that this spike was only partly due to a weakening of investor confidence in the LOC bank. The more significant factor was the lack of effort by the remarketing agent. First River Advisory arranged for a replacement remarketing agent six weeks after the interest rate spike first occurred. The new remarketing agent reduced the spread to the SIFMA Index to 25 basis points the very next week, and averaged a spread of nine basis points until the Series 2006 VRDBs were refunded at the end of 2009. This example illustrates the lack of tolerance by both Oaklawn and First River Advisory of poor performance by other professionals.

## Collapse of the ARS Market

Because the conventional wisdom at the time was that Radian's difficulties were temporary, and in an effort to minimize costs, the initial LOC had a term of only one year. After the ARS market collapsed entirely in early 2008, Radian's financial recovery, had it occurred, would not have mattered. First River Advisory assisted Oaklawn in the negotiation of three LOC renewals until the Series 2006 VRDBs were refunded in late 2009.

## 2008 Financial Crisis Implications

Although Oaklawn had weathered the deterioration of Radian's credit quality and the collapse of the ARS market, it was not yet completely out of the woods. The unprecedented events of 2008 affected Oaklawn just the same as larger health care organizations. But close collaboration between vigilant First River Advisory, nimble Oaklawn management and an engaged Oaklawn Board averted adverse financial consequences.

## 2006 Interest Rate Swap

Through a competitive process, Oaklawn had entered into the 2006 interest rate swap with an affiliate of Lehman Brothers, further guaranteed by its corporate parent, Lehman Brothers Holdings, Inc. (LBHI). Even though this affiliate did not declare bankruptcy in September 2008,

the bankruptcy filing by LBHI, as guarantor, represented an event of default. First River Advisory, together with special legal counsel, assisted Oaklawn in taking immediate steps protect its rights by suspending swap payments and filing notices to terminate the swap. The swap was terminated in December 2008. Subsequently, First River Advisory collaborated with Oaklawn's swap advisor to negotiate with a different counterparty a new swap differing from the Lehman swap in many respects, yet still meeting Oaklawn's objectives.

## BANK CREDIT SQUEEZE

While the cost of the initial LOC procured in 2007 in connection with the ARS conversion and remarketing was very attractive, it became necessary for First River Advisory to negotiate renewals during an especially "tight money" period. The difficulty of the task was compounded by Radian's continually deteriorating credit quality, as evidenced by multiple downgrades by rating agencies. First River Advisory devised various "work-arounds" so that the bank's approval of LOC renewals could be obtained at the least possible cost and with an improvement in their terms, conditions and covenants.

## AIG

Through a competitive auction process recommended by First River Advisory, the Series 2006 Debt Service Reserve Fund (DSRF) was invested in an American International Group (AIG) collateralized repurchase agreement. Though AIG was a strong credit at the time, its credit quality deteriorated substantially in mid-2008, and was eventually bailed out by the federal government. The collateralization should have afforded a measure of comfort, but, in this case, AIG has posted Freddie Mac securities as collateral. At the time, federal agency securities, such as those issued by Fannie Mae and Freddie Mac, were very common eligible collateral securities. Freddie Mac, too, became the subject of a federal government bailout.

Shelley Aronson of First River Advisory applied lessons learned while associated with the New York State Medical Care Facilities Finance Agency during the 1980s. During that time, other hospital bond issuing authorities were negatively affected by the collapse of Drysdale Securities, Lombard-Wall Incorporated and other "repo" dealers. First River Advisory has routinely taken extra care to ensure that repurchase agreement provisions in clients' bond documents contain all the essential safeguards. In Oaklawn's case, First River Advisory took steps to ensure that a third-party custodian indeed had control of the collateral, verified the accuracy of the weekly collateral valuations and confirmed that AIG honored margin calls by augmenting the collateral within the required time frame. Despite its attractive yield, the outcome of First River Advisory's extensive research was its recommendation that Oaklawn accept AIG's offer to terminate the repurchase agreement at par, which was accomplished in late 2009. First River Advisory managed the negotiations with AIG and arranged for the logistics of the termination.

## SERIES 2008 BONDS

As if these 2008 events weren't enough of a challenge, the relationship between Oaklawn and the bank which had purchased the Series 2005 Bonds had begun to break down after the departure of the original banker (a common risk in bank financings – faces change). The original bank, for which a merger was arranged by federal banking officials, was unable to respond to Oaklawn's needs, and its refusal to loosen a debt-to-capitalization ratio covenant obstructed Oaklawn's ability to incur additional debt for the next major facilities improvement project.

First River Advisory arranged for Chemical Bank, which has a local presence, to purchase Series 2008 Bonds to refund the Series 2005 Bonds. The structure of and the covenants applicable to the Series 2008 Bonds were largely the same, but the variable-rate spread over LIBOR was greater due largely to the adverse lending environment rather than any deterioration of Oaklawn's credit quality. First River Advisory calculated the additional cost, which Oaklawn was able to input into its forecasting model to estimate the financial feasibility of the new project, an example of First River Advisory's frequent collaboration with its clients in their evaluation of new business ventures.

## SERIES 2009 BONDS AND LOANS

Due to the convergence of several factors, it was becoming more and more evident through 2009 that the Series 2006 VRDBs had outlived their usefulness. First River Advisory solicited proposals from other financial institutions to collaborate with the LOC bank on the purchase of "bank-qualified" (BQ) bonds, taking advantage of a temporary provision of the American Recovery and Reinvestment Act of 2009 (the ARRA). The $30 million of BQ bonds purchased directly by Key Bank and Bank of America (BofA), together with conventional term loans, refunded the Series 2006 VRDBs at the end of 2009. These new debt instruments, which initially featured terms of over five years, stabilized Oaklawn's financing and eliminated the bank risk inherent with VRDBs. The terms of these debt instruments were subsequently extended until FY2017 by BofA and to FY2021 by Key Bank. The Series 2009A Bonds owned by Key Bank and Key Bank's 2009 Loan were refinanced in 2010 to take advantage of narrowing credit spreads. The refunding of the Series 2006 VRDBs also terminated the Radian bond insurance policy, which, by then, had diminished in value such that it represented a burden rather than a benefit.

## "OUTSIDE-THE-BOX" THINKING TO PRESERVE FLEXIBILITY

First River Advisory collaborated closely with Bond Counsel to design financing documents that would have the greatest chance of withstanding the expiration of the temporary ARRA provision. After the events of 2007 and 2008, one of First River Advisory's priorities was to ensure that Oaklawn could respond swiftly and effectively to changing circumstances, even those which were theretofore regarded as highly farfetched.

## Cultivating a New Bank

BofA, having narrowly survived the 2008 financial crisis, was no longer in a position satisfy Oaklawn's credit needs. Its predecessor institutions had long been Oaklawn's dependable local ally, but credit decisions became centralized and assigned to bankers who had little familiarity with hospitals, resulting in a curtailment of lending to community hospitals. Its credit exposure to Oaklawn was limited to approximately $22 million. Another bank was needed to refund the Series 2006 VRDBs, as well as to finance a surgical facilities replacement project (the Surgery Project) which had been deferred from 2009 to 2010.

In response, First River Advisory solicited proposals from other banks to purchase some of the Series 2009 Bonds, plus have sufficient credit capacity to play the lead role in financing the Surgery Project. Despite the challenging bank environment, First River Advisory was able to present two viable proposals, the better of which was submitted by Key Bank. With banks' new focus on obtaining "non-credit" business in connection with their credit facilities, First River Advisory devised a split of Oaklawn's non-credit business which was acceptable to both BofA and Key Bank, no easy feat for a community hospital without extensive cash management needs.

## Favorable Structure

First River Advisory negotiated a favorable structure featuring the following elements:

- at least 6 months' notice of renewal decisions before mandatory tender dates;
- no origination fees;
- no change in pricing due to changes in Oaklawn's rating;
- no prepayment penalties;
- no DSRF required for Series 2009 Bonds, which supported the termination of the AIG repurchase agreement;
- no "material adverse change" ("MAC") clauses; and
- financial covenants that would not inhibit Oaklawn from being able to finance the Surgery Project.

The variable-rate Series 2009 Bonds meshed reasonably well, but not seamlessly, with the interest rate swap implemented earlier in the year, thereby preserving the synthetic fixed rate that was a cornerstone of the 2006 Financing Plan.

## SERIES 2010 BONDS AND 2010 LOAN

With the 2006 Project nearing completion, Oaklawn commenced planning for the Surgery Project. Originally scheduled to commence construction in 2009, the Surgery Project had been postponed until 2010. By then, Oaklawn had accumulated ten smaller projects to include in the financing.

## LONG, DELIBERATE PLANNING

As is Oaklawn's custom, planning for the financing of the Surgery Project commenced well in advance. First River Advisory began its role in this process during the autumn of 2008 by identifying and evaluating all possible financing alternatives. In addition to the BQ bonds approached used in 2009, First River Advisory examined:

- long-term, fixed-rate bonds sold via a public offering based on Oaklawn's credit, with no enhancement;
- VRDBs backed by LOCs issued by a group of smaller banks, all wrapped by a master LOC issued by the Federal Home Loan Bank, which would have taken advantage of a temporary authorization enacted by Congress;
- a HUD-242 insured mortgage loan; and
- a combination of direct and guaranteed loans through the Rural Development Administration of the U.S. Department of Agriculture under its Community Facilities (CF) program.

Each alternative had its own unique set of availability, costs, risks and implementation factors. In addition, a simple "repeat" of the Series 2009 BQ Bonds was not possible because of credit exposure constraints imposed by the two banks – $30 million for Key Bank, and $8 million for BofA. Thus, if the BQ bonds alternative were to be selected, the maximum amount of debt which Oaklawn could incur would be $38 million. These evaluations continued through 2009 until March 2010, when Oaklawn adopted a Financing Plan which specified the BQ bond alternative.

Implementation commenced shortly thereafter but was suspended when Congress appropriated additional funding for CF direct loans. Oaklawn's focus then turned to the preparation of an application for a $40-plus million CF direct loan. When this application was not approved and the appropriation exhausted to fund approved projects, Oaklawn returned to the BQ bonds alternative in October 2010.

## IMPLEMENTATION

First River Advisory spearheaded the implementation, which had to result in the issuance of the BQ bonds by the end of the year because of the expiration of the special ARRA provision. In addition to its usual "deal management" function, First River Advisory continually evaluated the differences between natural and synthetic fixed rate structures, the latter involving several possible interest rate swap strategies. First River Advisory collaborated closely with Oaklawn's swap advisor to define and evaluate alternatives, and to implement the selected option. As it had in the past, the swap advisor reduced its fees due to First River Advisory's substantial involvement.

Structurally, the Series 2010 Bonds and 2010 Loan were similar to their 2009 counterparts. First River Advisory was able to negotiate a ten-plus year mandatory tender provision for the Series 2010 Bonds which was then applied to Key Bank's Series 2009A Bonds.

## PROJECT PLANNING AND CON

As with the 2006 Project, First River Advisory coordinated project planning and CON matters for the Surgery Project with the capital financing. Once again, First River Advisory provided the information necessary for Oaklawn to complete the capital financing sections of the CON application.

One significant additional element related to the banks' requirement of construction oversight. First River Advisory collaborated with Oaklawn's attorney and coordinated with Oaklawn's architect and construction manager in negotiating provisions of the banks' construction monitoring agreement. The outcome proved to be satisfactory, as no material issues arose during the development of the Surgery Project.

## SERVICES IN BETWEEN FINANCINGS

Between the issuance of the Series 2010 Bonds and 2010 Loan and mid-2015, First River Advisory has assisted Oaklawn with several debt management projects:

- a restructuring of the interest rate swap to match the terms of the Series 2009 Bonds and 2009 Loans;
- research on the impact of a downgrade of the rating on one of Oaklawn's swap counterparties and the evaluation of alternative courses of action, including the "do nothing" alternative which Oaklawn eventually selected (and turned out to be the right choice);
- negotiation of an extension of the terms of BofA's Series 2009B Bonds and 2009 Loan;

- establishment of a clear linkage between Oaklawn's right to set-off its payments to Key Bank (as Series 2009A and 2010 Bondholder and a lender) against payment shortfalls by a related swap counterparty;

- amendments to financing documents and other procedures necessitated by Oaklawn's change of its fiscal year;

- collaboration with Oaklawn's former chief financial officer on a case study presented to an advanced health care financial management class at the University of Michigan's School of Public Health; and

- explanation of Oaklawn's debt structure to new financial management personnel.

## SERIES 2016 BONDS

Oaklawn's Series 2009B Bonds were subject to mandatory tender on February 1, 2017, and BofA's 2009 Loan and 2010 Loan matured on the same date (the 2017 Maturing Debt Instruments). Failure to address these upcoming events, either by extending the terms of these 2017 Maturing Debt Instruments or by refinancing them, would have resulted in a balloon payment of nearly $30 million. That balloon payment would have represented approximately 66 percent of Oaklawn's financial assets at the time. By design, Oaklawn held termination options on February 1, 2016 and annually thereafter at one percent premiums with respect to interest rate swaps associated with these 2017 Maturing Debt Instruments with Morgan Stanley Capital Services (the MS Swap) and Key Bank (the Key Swap). Thus, February 1, 2016 represented the first date on which Oaklawn had an opportunity to address these events by redeeming the Series 2009B Bonds, prepaying BofA's 2009 and 2010 Loans (all at par) and terminating the MS Swap and Key Swap. What presented as an opportunity in 2016 would have become a necessity by February 1, 2017.

## PLANNING PHASE

First River Advisory's financial advisory engagements relating to a financing are typically divided into two phases:

1. Planning, which culminates in the adoption of a definitive Financing Plan; and

2. Implementation of the Financing Plan.

The situation which needed to be addressed and the deadline by which a solution needed to be in place provided the framework for this paradigm.

## 2015 Activities

First River Advisory commenced its engagement in mid-2015 by opening discussions with BofA regarding its interest in extending the terms of these debt instruments. BofA indicated its unwillingness to do so, despite its decades-long relationship, mainly because Oaklawn's size and credit characteristics no longer fit the bank's lending criteria. Oaklawn had encountered a similar predicament in connection with its Series 2005 Bonds, and First River Advisory had pointed out this risk in connection with the 2009 and 2010 financings. Accordingly, Oaklawn and First River Advisory were well-prepared to meet this challenge.

First River Advisory recommended that Oaklawn commence discussions with Chemical Bank and Key Bank, the two banks which already had credit exposure to Oaklawn by virtue of their ownership of the Series 2008 Bonds, Series 2009A Bonds and Series 2010A Bonds. Those contacts were augmented by discussions with other banks which First River Advisory had identified as having interest in extending credit to hospitals like Oaklawn. The outcome of a first round of discussions held in September 2015 was promising, leading First River Advisory to conclude that a satisfactory solution could be implemented prior to February 1, 2016. However, the process was discontinued after Oaklawn received notice that a group of four orthopaedic surgeons planned to relinquish their medical staff privileges as of January 1, 2016. First River Advised that Oaklawn would present a better credit profile once a solution to this issue could be determined and its implementation underway.

Even though efforts to effectuate a refinancing of the 2017 Maturing Debt Instruments had been suspended, Oaklawn still had the option to terminate the MS Swap and Key Swap on February 1, 2016. First River Advisory found during the September 2015 round of bank discussions that banks would offer natural fixed rates for as long as ten years. With the high likelihood that natural fixed-rate debt instruments could be issued to refinance the 2017 Maturing Debt Instruments sometime prior to February 1, 2017, those swaps would no longer be necessary to hedge interest rate risk beyond one year. First River Advisory calculated "worse-off" interest rate scenarios if Oaklawn were to elect to terminate the swaps and conclude a refinancing sometime during the upcoming year. After careful consideration of the facts and First River Advisory's analyses, Oaklawn determined to pass on its termination options.

## Pivotal Event

Through early 2016, both Oaklawn and First River Advisory continued to expect that one or more banks would be involved in the refinancing of the 2017 Maturing Debt Instruments, most likely through the direct purchase of tax-exempt bonds. First River Advisory began to lay the foundation for the refinancing at Oaklawn's April 2016 Board meeting by framing the priority issues:

1. Because BofA had already notified Oaklawn that it would not be renewing, the February 1, 2017 "judgement day" was real and that "do nothing" would not be a viable alternative; and

2. Secondarily, the rating on Deutsche Bank, the counterparty of a third interest rate swap (the DB Swap) had been downgraded, and had been (and continues to be) the subject of adverse news headlines regarding its credit quality.

First River Advisory's presentation provided essential background information to Board members, most of whom were new to the Board since the 2010 financings.

On April 29, 2016, First River Advisory reported to Oaklawn that based on its surveillance of the market for long-term, fixed-rate (LTFR) tax-exempt bonds, market conditions had improved dramatically, especially for weak-credit hospital bonds. If Oaklawn were to elect to issue LTFR bonds to address the 2017 Maturing Debt Instruments, those bonds would have to appeal to investors in this market segment. Among the evidence cited by First River Advisory was:

- the 2040 maturity of a high-yield (below-investment-grade) bond issue for a Pennsylvania critical access hospital was sold at a 4.30 percent yield, 181 basis points above the MMD Aaa/AAA general obligation bond index (the Benchmark Index), which represented a new all-time low yield for below-investment-grade hospital bonds; and

- the market absorbed nearly $1 billion of below-investment-grade bonds for Loma Linda Medical Center at a 4.70 percent yield for a 2056 maturity.

First River Advisory then postulated that perhaps market conditions had improved sufficiently to enable Oaklawn to refinance not only the 2017 Maturing Debt Instruments, but all the rest of its debt except the Series 2008 Bonds (the Refunded Debt Instruments) and terminate all three interest rate swaps.

Contemporaneously, Oaklawn management had prepared extended financial projections for use in a strategic planning retreat with the Board. For lack of any better assumptions, projected interest expense had been held constant at the FY2016 level. Using this interest expense as a constraint, First River Advisory tested its hypothesis by constructing a LTFR bond issue using yields consistent with those at which recent high-yield bond issues had been sold. First River Advisory found that "without trying hard" to fine-tune yields, a LTFR bond issue which accomplished all the objectives would increase Oaklawn's FY2018 net aggregate interest expense by only $100,000.

## FINANCING PLAN DECISION-MAKING PROCESS

After the time to address capital financing issues was cut short at Oaklawn's April 2016 Board meeting due to more pressing issues, First River Advisory recommended that Oaklawn convene a task force consisting of a few of the more financially-astute Board members to address these matters in greater detail (the Bond Group). The first meeting of the Bond Group in June 2016 was devoted to a more exhaustive discussion of the information presented at the April Board meeting, together with First River Advisory's introduction of the LTFR concept.

After having experienced adverse effects of risk-taking and taking into account future operational challenges, Oaklawn's appetite for risk had waned. The LTFR concept, therefore, represented an approach to "de-risk" Oaklawn's balance sheet without incurring much, if any additional cost. As First River Advisory expected, the Bond Group endorsed the LTFR approach, which short-circuited the need to discuss further risk tolerance parameters which would have evolved into debt and interest rate swap policies. The Bond Group directed First River Advisory and Oaklawn management to analyze different variations on the LTFR theme (Refunding Scenarios):

- extending the final maturity beyond 2042;
- deferring amortization for a number of years;
- departing from a traditional level debt service schedule; and
- adding different amounts of debt beyond the refinancing to finance new capital assets.

First River Advisory recommended that the transaction be completed prior to Election Day because of uncertainty thereafter, which was endorsed by the Bond Group.

First River Advisory and Oaklawn management constructed eight Refunding Scenarios that were considered by the Bond Group at its July meeting. All Refunding Scenarios contemplated the issuance of LTFR Series 2016 Refunding Bonds for the purpose of refunding the Refunded Debt Instruments and having the following characteristics in common:

- selection of the County of Calhoun Hospital Finance Authority as the conduit issuer;
- a November 1, 2016 closing date (prior to Election Day);

- Series 2016 Refunding Bonds maturing on February 15, close to the end of Oaklawn's fiscal year so "bond years" would correspond closely to Oaklawn's fiscal years;

- a final maturity on February 15, 2047;

- variable-rate Series 2008 Bonds remaining outstanding, with the interest rate risk mitigated by Oaklawn's purchase of an interest rate cap at 2 percent via a single up-front payment;

- deferred amortization of the Series 2016 Refunding Bonds through at least FY2021 to "wrap-around" principal repayments of the Series 2008 Bonds and payments on capitalized leases; and

- terminating the DB Swap at its mid-market value on November 1, 2016 but waiting until February 1, 2017 to terminate the MS and Key Swaps by exercising their respective termination options, both at the one percent premium.

All Refunding Scenarios were designed to eliminate virtually all of Oaklawn's financing risk by refunding the Refunded Debt Instruments and terminating all swaps. First River Advisory assisted Oaklawn management with integrating these Refunding Scenarios into its financial projection model.

At its July meeting, the Bond Group endorsed the plan to issue LTFR Series 2016 Refunding Bonds, including $10 million to finance new capital assets provided that FY2018 interest expense would not increase beyond that reflected in the May financial projections. Oaklawn's Board ratified this Financing Plan later in July. The Implementation Phase commenced immediately thereafter, with the timetable specifying a November 1 closing date, a week before Election Day.

## IMPLEMENTATION PHASE

First River Advisory led the implementation of the Financing Plan in a comprehensive manner. First River Advisory takes prides in its ability to manage financing processes so that transactions can be completed on time, in an efficient manner and synchronized with clients' other events and priorities. As explained further below, First River Advisory is particularly proud of three recommendations that contributed mightily to the success of the Series 2016 Refunding Bonds:

1. to complete the transaction prior to Election Day;

2. to adopt a comprehensive approach to disclosure; and

3. to offer covenants that would be perceived as investor-friendly yet would not compromise Oaklawn.

## FINANCING TEAM

First River Advisory recommended that Oaklawn take advantage of an opportunity to appoint a “Top 10” bond counsel firm with nationwide perspective represented by a Michigan partner who was highly familiar with Oaklawn and its prior financings through her previous association. The selection of a large firm having abundant resources proved to be a wise choice because the Michigan partner was able to muster assistance from colleagues located around the country:

- another partner who is knowledgeable in hospital transactions, located in Newark, New Jersey;
- an experienced associate located in Washington DC; and
- tax counsel located in San Francisco.

The Michigan partner’s close attention to detail proved to be an asset to the transaction as well.

The incumbent Master and Bond Trustee became involved with Oaklawn when it purchased the corporate trust business of the bank which Oaklawn had selected in connection with issuance of the Series 2006 Bonds. It had not managed the transition well, and First River Advisory had lost confidence in its capabilities in connection with other clients. First River Advisory recommended a change, and a successor was selected on the basis of quality of service, stability of personnel and fees consistent with the market. Although it was necessary to overcome a few rough spots, this selection proved its worth.

First River Advisory circulated a request for proposals (RFP) to eight investment banking firms to underwrite the Series 2016 Refunding Bonds, and received six proposals. Because the Financing Plan was substantially set, the RFP was not used to solicit financing ideas and approaches, because First River Advisory does not rely on investment bankers or others to identify and evaluate financing approaches in the course of developing Financing Plans. The RFP was heavily oriented toward investment banking firms’ ability to execute the transaction. First River Advisory explained to Oaklawn that emphasis should be placed on value, not necessarily the least expensive underwriting discount. First River Advisory demonstrated to Oaklawn that the difference between the least-costly proposal and the several at the median would be neutralized by a two basis point difference in the yield of the Series 2016 Refunding Bonds.

## RATINGS

Standard & Poor's Global Ratings (S&P) had rated Oaklawn's Series 2006 Bonds. That rating was converted to an institutional credit rating (ICR) after the Series 2006 Bonds were redeemed in 2009. The ICR was withdrawn at Oaklawn's request in 2013. Because S&P's periodic rating updates had been contentious at times, First River Advisory recommended that Oaklawn refrain from applying for an S&P rating on the Series 2016 Refunding Bonds.

During the Planning Phase, First River Advisory supplemented its own analytics with a rating scorecard published by Moody's Investors Service (Moody's) to gauge Oaklawn's credit quality. Although by no means definitive, the scorecard indicated that Oaklawn might be able to achieve an investment-grade rating from Moody's.

First River Advisory recommended that Oaklawn apply to both Moody's and to Fitch Ratings (Fitch) for indicative ratings, which need not be disclosed. Depending on the outcomes, Oaklawn would have the option to continue the rating processes so that one or both indicative ratings could be published and used to market the Series 2016 Refunding Bonds. First River Advisory assembled a decision matrix based on the outcome of the indicative rating processes.

| | ***Moody's*** | | |
|---|---|---|---|
| ***Fitch*** | ***Baa3*** | ***Ba1*** | ***worse*** |
| ***BBB-*** | Publish both | Publish both | Publish BBB- |
| ***BB+*** | Publish Baa3 | Publish Ba1 | Publish BB+ |
| ***worse*** | Publish Baa3 | Publish Ba1 | Publish neither |

This matrix was endorsed by all respondents to the investment banking RFP with only a few minor comments. The shaded cell denotes the outcome of the indicative rating processes.

Because of the long lead times, First River Advisory scheduled site visits with Moody's and Fitch for early September even before the Financing Plan was adopted in late July. As has been its practice, First River Advisory took the lead in drafting information for the rating agencies, orchestrating the presentations by Oaklawn representatives and conducting rehearsals for the presentations.

## DISCLOSURE

First River Advisory believes that a comprehensive Appendix A (the disclosure section) to an Official Statement (OS) that is well-organized, exhaustive and well-written is more user-friendly to institutional bond analysts who are critical in the investment decision processes at their firms.

First River Advisory routinely advises its clients that the Appendix A should contain "answers to every question ever asked" by bond analysts. By including all factual information in the Appendix A, interactions between hospital representatives and analysts, be they via conference calls, webcast road shows or site visits, can focus on adding "color" to the data and on analysts' more probing questions that typically begin with "what do you think about..." or "what do you plan to do about..." No time is wasted during these interactions chasing down raw data. Also, the borrower is better able to satisfy uniform-disclosure standards because all factual data is contained in the Appendix A and not supplied separately. Early on, Oaklawn accepted First River Advisory's recommendation to present "above-and-beyond" disclosure to potential investors in Appendix A to the OS for the Series 2016 Refunding Bonds.

Over the years, several analysts have remarked that they tend to examine OS's featuring Appendix A's drafted by First River Advisory before others because of their user-friendly traits. As an example of completeness, the Appendix A relating to the high-yield bond issue for the Pennsylvania critical access hospital cited earlier was only 21 pages, whereas that for Oaklawn's Series 2016 Refunding Bonds was 92 pages. The table of contents from this Appendix A is attached.

By the time the Preliminary OS for the Series 2016 Refunding Bonds was circulated on October 6, the market had been flooded with new bond issues. Bond analysts' time was consumed with analysis of all these new issues, so there was no time to request additional information beyond that contained in Oaklawn's Appendix A or for much dialogue between analysts and Oaklawn representatives. Analysts whose firms purchased Series 2016 Refunding Bonds commented that the quality and comprehensive nature of this Appendix A were key factors in their firms' investment decisions. Although impossible to quantify, First River Advisory believes that Oaklawn's adoption of this approach resulted in lower yields on the Series 2016 Refunding Bonds.

## SECURITY, COLLATERAL AND COVENANTS

First River Advisory recommended that a depository account control agreement (DACA) that was first implemented in connection with the issuance of Oaklawn's Series 2005 Bonds be preserved in an Amended and Restated Master Indenture and Security Agreement in connection with the Series 2016 Refunding Bonds. The DACA augments the usual gross revenue pledge by granting a perfected security interest in the account into which Oaklawn's receipts are deposited, without running afoul of restrictions with respect to Medicare payments. Both Moody's and Fitch cited this security feature as a positive factor in their rating determinations. The cost to Oaklawn to maintain the DACA is nominal, and, unless a payment default were to occur, its presence creates no operational burdens. This is one example of ways that hospitals can reduce their interest expense with little downside.

Based on responses to the investment banking RFP, First River Advisory recommended that a debt service reserve fund (DSRF) not be included as security for the Series 2016 Refunding Bonds.

The yield on the highest-yielding permitted investment for a DSRF at the time would have been over 300 basis points negative to that on the Series 2016 Refunding Bonds. That negative arbitrage would have cost Oaklawn more than $150,000 annually.

First River Advisory recommended that the amount of title insurance be limited to the $45.8 million which was already in place. Through its dialogue with bond analysts over the years, First River Advisory had learned that they would be satisfied if there were a "meaningful" amount of title insurance. There was no "pushback" at all from any of the bond analysts who considered Oaklawn' Series 2016 Refunding Bonds for investment in their firms' portfolios.

To promote the marketability of the Series 2016 Refunding Bonds, Oaklawn accepted First River Advisory's recommendations to "beef up" the typical continuing disclosure requirements by agreeing to:

- report the incurrence of additional debt and other material events which are not (yet, anyway) required under SEC Rule 15c2-12;
- hold semiannual conference calls with beneficial owners of the Series 2016 Refunding Bonds; and
- designate the failure to comply with reporting requirements as an event of default, though with an opportunity to cure.

The Series 2016 Refunding Bonds actually have fewer financial covenants than the Refunded Debt Instruments:

- the debt service coverage ratio (DSCR) covenant was reduced to 1.10 times maximum annual debt service (MADS);
- the debt-to-capitalization ratio covenant will be eliminated completely after the Series 2008 Bonds are fully redeemed in FY2021; and
- the DSCR covenant is now measured only annually, not quarterly;
- the liquidity covenant will be measured only annually after FY2021, not semiannually.

Rules for calculating MADS were also clarified to facilitate compliance going forward.

## Structural Features

Nearly all of the structural features of the Series 2016 Refunding Bonds that were specified in the Financing Plan were preserved. However, deteriorating market conditions caused Oaklawn to abandon issuing any Series 2016 Refunding Bonds for new capital assets which, all along, had been considered a "nice-to-have" rather than a "have-to-have."

Principal repayment of the Series 2016 Refunding Bonds is deferred until FY2024, so Oaklawn can expect to be able to build cash during the three fiscal years in which no principal repayments on any debt instruments are scheduled. Despite this deferral, the WAM of the Series 2016 Refunding Bonds is approximately three years shorter than the average useful life of the projects financed by the Refunded Debt Instruments.

## Bond Marketing and Pricing

First River Advisory collaborated with the underwriters in the marketing process. In addition to the usual marketing efforts, two more extraordinary strategies were employed:

1. Oaklawn's CFO's attendance at the senior managing underwriter's investor conference, during which he had the opportunity to visit with bond analysts face-to-face (the coincidence of this investor conference and the timetable for the Series 2016 Refunding Bonds was a factor which favored the selection of this investment banking firm as the senior managing underwriter); and

2. the recording of a webcast "roadshow" investor presentation which was viewed by 19 investment analysts.

First River Advisory's role in responding to bond analysts' questions was, as expected, limited due to the completeness of the Appendix A.

First River Advisory closely monitored the pricing process to ensure that there were not materially more orders than bonds. Some financial advisors and investment banking firms consider bond issues that are oversubscribed multiple times to be accomplishments. In contrast, First River Advisory attributes those situations to bond yields that were higher (more attractive to investors) than necessary. The Series 2016 Refunding Bonds were only 1.59 times oversubscribed, most of which were related to the 2027 through 2031 maturities, enabling yields on those maturities to be reduced by two basis points each. The all-in true interest cost (equivalent to an APR) of the Series 2016 Refunding Bonds was 4.66 percent. FY2018 interest expense exceeded that projected in May by $156,000, enabling Oaklawn to achieve all of its objectives at little additional cost.

There were no directly comparable bond issues to which the yield on the Series 2016 Refunding Bonds could be compared, a common occurrence in the high-yield market. First River

Advisory pointed out that both of Oaklawn's main competitors, both rated in the "A" category, had issued bonds shortly before the Series 2016 Refunding Bonds at yields approximately 100 basis points lower. Despite its weaker credit quality, there was no question about Oaklawn's "access to capital," and the extra cost of that capital could be quantified.

## Transaction Closing

First River Advisory orchestrated the closing of the transaction. First River Advisory's tasks included:

- performance of bond sizings and other quantitative analyses;
- arrangement for the payoffs of debt instruments being refinanced;
- in collaboration with Oaklawn's swap advisor, termination of the three interest rate swaps;
- provision of information to tax counsel and review of tax documents;
- preparation of the closing flow of funds memorandum and coordination with the Bond Trustee for the disposition of bond proceeds;
- commentary on the "pricing book" prepared by the senior managing underwriter and the addition of relevant information which had been omitted.

Since the closing of the Series 2016 Refunding Bonds, First River Advisory has implemented Oaklawn's investor relations platform using *BondLink*. According to *BondLink*, Oaklawn is the first health care organization to have done so.

## Ongoing Services

First River Advisory continues to provide a variety of ongoing services to Oaklawn, including:

1. Dissemination Agent with respect to annual and quarterly disclosure reports and compliance with other continuing disclosure requirements;
2. continual maintenance of Oaklawn's *BondLink* investor relations platform;
3. coordination of responses to questions submitted by *BondLink* users;

4. maintenance of relationships with beneficial owners of the Series 2016 Refunding Bonds and Oaklawn's other financial stakeholders;

5. preparation for annual rating updates;

6. periodic updating of the Summary of Financial Covenants;

7. review and comment on proposed changes to Oaklawn's investment policy;

8. supplying of data and other input to support Oaklawn's preparation of its annual operating and capital budgets;

9. arrangement for arbitrage rebate calculations;

10. annual completion of Schedule K of IRS Form 990;

11. review and comment on the audit footnote relating to Oaklawn's debt instruments;

12. advice on debt-related compliance issues (i.e., non-exempt use of bond-financed property);

13. cultivation of other sources of credit and participation in meetings with such sources; and

14. monitoring of the credit quality of financial institutions to which Oaklawn has credit exposure or would otherwise be relevant, and provide applicable rating agency and other relevant reports to Oaklawn.

**REFERENCE**:

Gregg Beeg, Interim Chief Executive Officer
(269) 789-3924
Gbeeg@oaklawnhospital.com

# THE BOND BUYER

**THE DAILY NEWSPAPER OF PUBLIC FINANCE**
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## *Radian Insurance Not Enough for Oaklawn*

by *Matthew Hanson*

Radian Asset Assurance Inc.'s bond insurance is no longer enough for Michigan-based Oaklawn Hospital.

In the face of mounting yields on its Radian-backed auction-rate bonds since early August, Oaklawn recently arranged for an extra letter of credit to help bring down the rising cost of interest on $37.8 million of bonds it issued last year.

Several other issuers have found the yields on their Radian-backed auction- and variable-rate bonds rising since plans for the bond insurer's parent company to merge with MGIC Investment Corp. gradually dissolved and Fitch Ratings dropped its rating on the insurer to A-plus from AA.

While the rating agencies said they have several other issuer clients considering additional credit enhancement for their Radian-backed bonds, Oaklawn will be the first to finalize its plans. The LOC from LaSalle Bank NA will be added on Wednesday, when the bonds are switched from an auction-rate mode to pay investors based on a variable rate.

"The normal condition is that you would get a standby bond purchase agreement only because — given that you have Radian bond insurance, which stays — you would only need to pay somebody for liquidity," said Standard & Poor's director Jeff Previdi.

Oaklawn opted for a letter of credit to help bring down the recent spike in rates on the bonds caused by investors' reaction to the string of bad news from Radian in the past few months — something the hospital's financial adviser call "irrational behavior."

"We figured, 'hey, let's minimize the cost with a one-year letter of credit,' " said the adviser, Shelley Aronson, president of First River Advisory LLC. "Hopefully, one year is enough for this to blow over, if it's going to blow over at all."

The Oaklawn bonds, which mature in 2037 and reset every two weeks, were first auctioned at 3.78% on July 31, Aronson said. That was the day after the bond insurer's parent company, Radian Group Inc., said it would take as much as $518 million of impairments on a joint venture that was being inundated with calls for collateral.

When the bonds reset again on Aug. 14, they were set at 5.00%, according to Aronson. The following reset raised the rate to 6.40%, and each reset since then has seen the bonds auctioned at 6.75%. The added interest was costing Oaklawn more than $40,000 every two weeks, Aronson added.

The bonds carry an underlying rating of BBB-minus from Standard & Poor's.

Radian has worked hard to strengthen market confidence in its double-A bond insurance since the Radian Group called off its merger with MGIC. While the insurer's role is not to give advice on how to handle a spike in reset rates, Radian has been active in responding to information requests and other questions from issuers like Oaklawn, said Paul Rizzo, senior vice president and manager of public finance at Radian.

Oaklawn is not alone in its attempts to diffuse rising interest rates on their Radian-backed bonds.

The Orlando Regional Healthcare System Inc. said in disclosure documents last month that investors were peppering its finance professionals with questions about how the system would handle sharp rate increases during the 35-day resets for its 1999 bonds. The central Florida-based system has a cost-of-funds swap in place right now, which has so far insulated it from the costs of rising rates.

It also became clear in September that Mount Saint Mary College and the Pratt Institute — both in New York — were looking for ways to bring down rates on their variable-rate demand obligations operating in weekly reset mode. An official from the Dormitory Authority of the State of New York said at the time that DASNY would help the colleges consider options, such as refunding the Radian-backed bonds or buying extra bond insurance or letters of credit.

Oaklawn decided that refunding its bonds was not a prudent choice because the hospital had already paid a premium of more than $1 million to buy the Radian insurance on the bonds.

Aronson said the costs of additional interest during the past few months, along with the charges for restructuring the bonds to variable rate, will end up costing the hospital about $375,000, but that Oaklawn is seeing it as a way to prevent even steeper interest costs.

So long as the extra LOC brings down the rates, these costs should not materially affect the hospitals finances, said Colleen Koppenhaver, Oaklawn's chief financial officer.

"In the anticipation that it will be short-lived here — it is only a blip."

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