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NAMA
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CLIENT SPOTLIGHT

HILLSDALE HOSPITAL

$12,175,000
City of Hillsdale Hospital Finance Authority
Hospital Revenue Bonds, Series 1998
June 1998

$22,000,000
City of Hillsdale Hospital Finance Authority
Hospital Revenue and Refunding Bonds, Series 2011
September 2011

$4,990,000
City of Hillsdale Hospital Finance Authority
Hospital Revenue Refunding Bonds, Series 2012
December 2012

$23,015,000
City of Hillsdale Hospital Finance Authority
Hospital Revenue Refunding Bonds, Series 2013
April 2013

$25,820,000
U.S. Department of Agriculture, Rural Development
Community Facilities Direct Loan
December 2016

First River Advisory has served as Financial Advisor to Hillsdale Hospital since the issuance of its Series 1998 Bonds. Hillsdale operates a community hospital in a small town in south-central Michigan which recorded $61 million of operating revenue in its fiscal year (FY) ended in June 2016. During that FY, Hillsdale admitted over 2,500 inpatients and delivered over 12,000 days of care to residents of its skilled nursing units.

SERIES 1998 BONDS

Hillsdale's Series 1998 Bonds were long-term, fixed-rate obligations sold to both institutional and individual investors on the basis of Hillsdale's "BBB–" rating from Standard & Poor's Ratings Services (S&P). The Series 1998 Bonds financed various facilities improvement projects and equipment acquisitions, and refinanced "HELP Loans" from the Michigan State Hospital Finance Authority's pooled Hospital Equipment Loan Program. Market conditions were among the best-ever at the time, resulting in a bond issue which featured:

- a weighted average maturity of approximately 17½ years to a final maturity in 2026, which closely matched the useful lives of the assets financed and refinanced;
- a yield of approximately 5.42 percent;
- only a gross revenue pledge and a "negative pledge" on Hillsdale's real property (no mortgage) as security; and

- only an annual debt service coverage ratio covenant.

In planning for the issuance of the Series 2011 Bonds, it became readily apparent that these Series 1998 Bonds were "keepers." As outlined below, certain characteristics presented genuine challenges in connection with the issuance of the Series 2011 Bonds.

HELP LOANS

Between 1998 and 2008, First River Advisory continued its relationship with Hillsdale as Dissemination Agent with respect to continuing disclosure information and as Financial Advisor in connection with the negotiation of new HELP Loans. Implementing the second of the HELP Loans in 2006 was particularly challenging because of the credit bank's requirement to have a security interest in Hillsdale's gross revenue on a parity with that of the Series 1998 Bondholders. Because the issuance of the Series 1998 Bonds preceded the widespread application of "master indenture" security structures to financings for stand-alone community hospitals, this parity security interest had to be implemented using an intercreditor agreement among the credit bank, the City of Hillsdale Hospital Finance Authority (the Local Authority) as issuer of the Series 1998 Bonds, and the trustee for the Series 1998 Bonds (the Bond Trustee).

SERIES 2011 BONDS

In 2007, Hillsdale was awarded a certificate of need (CON) to replace skilled nursing beds that had been operated by an independent investor-owned facility which had been decertified by Medicare and Medicaid. Because these additional skilled nursing beds could not be accommodated within Hillsdale's existing facility, Hillsdale commissioned the design of a new two-story North Addition to house these new skilled nursing beds, together with a replacement obstetrical (OB) unit. Hillsdale obtained a CON for the new OB unit, plus another CON to permit the expansion of the existing skilled nursing unit into the vacated OB unit situated on the same floor. By the time financing could be arranged in September 2011, the cost of these projects had increased to approximately $15½ million.

FINANCING ENVIRONMENT

First River Advisory was engaged as Financial Advisor in early 2008. In a presentation to Hillsdale's governing board in December 2008, First River Advisory observed that "*unprecedented disruption [in the capital markets] makes planning [for the financing] exceptionally difficult*." At the time,

- U.S. Treasury yields were among all-time lows as a result of "flight to quality" among investors;

- tax-exempt variable rate demand bond (VRDB) rates were favorable (having recovered from a spike to over nine percent in late September), but access was an issue;

- fewer banks were extending credit, and those still active were being more stingy with credit, despite the implementation of the Troubled Asset Relief Program (TARP);

- long-term tax-exempt bond yields exceeded Treasury yields;

- there were significant outflows among tax-exempt bond funds, traditionally the most prominent investors in long-term, fixed-rate hospital bonds;

- credit spreads among tax-exempt bonds were historically wide (very much unlike mid-1998 when the Series 1998 Bonds were issued); and

- Hillsdale's Series 1998 Bonds had lost considerable value, indicating that a similarly-structured long-term, fixed-rate bond issue to finance the new projects would command a higher yield; but

- fortunately, Hillsdale wouldn't need financing until well into 2009.

For various reasons, many beyond Hillsdale's control, the financing was not accomplished until September 2011.

CHALLENGES

First River Advisory encountered several unique challenges in developing and implementing the Series 2011 Bonds. One affected hospitals generally, but others were particular to Hillsdale.

Partly due to the widespread financial turmoil during late 2008 and early 2009, Hillsdale suffered a setback when its financial performance weakened significantly. Citing a sizable operating loss and reduced patient service volumes during FY2009, together with a depressed local economy, S&P downgraded the rating on Hillsdale's Series 1998 Bonds from "BBB–" to "BB+" and assigned a negative outlook. By then, Hillsdale had already begun to reorient its priorities from financing the projects to improving its operational and financial performance. The measures implemented during FY2009 and FY2010 enabled Hillsdale to return to profitability in FY2010. Though this improvement was not sufficient to restore the investment-grade rating, S&P did change its outlook to stable from negative in September 2010.

In 2002, Hillsdale had guaranteed the debt of a company formed by affiliated physicians for the purpose of developing a medical office building (MOB) to house their practices. This guarantee had an inordinate impact on Hillsdale's debt service coverage ratio for annual covenant compliance purposes. As the financing approached, it became apparent that this single factor could force Hillsdale to refinance its Series 1998 Bonds, which would have increased both cost and risk. Moreover, this impact would have become exacerbated after the end of FY2011. First River Advisory devised a solution to substitute a bank line of credit for this guarantee. However, because Hillsdale could not meet the test for additional parity debt due to the presence of the guarantee, the line of credit had to be secured by assets not already pledged to the Series 1998 Bondholders. First River Advisory crafted a collateral package acceptable to the bank, and negotiated a five-year facility that provides for a ten-year, fully-amortizing repayment of any drawings at a favorable interest rate.

By its FY2011, Hillsdale's financial performance had improved markedly. Its operating margin topped 3½ percent, its days' cash on hand approached 119, and its debt-to-capitalization ratio had fallen to less than 33 percent. Even though the Series 2011 Bonds would increase Hillsdale's debt burden significantly, it was clear by most common measures that Hillsdale had sufficient capacity to incur the debt and sufficient cash flow to service it. Hillsdale, however, imposed a higher standard – that the skilled nursing units and the OB unit would have to produce sufficient cash flow to service the debt without any "subsidy" from other operations. As a result, it became imperative to limit the cost of the financing. First River Advisory warned in its December 2008 Board presentation that Hillsdale would likely have to assume some risk in order to achieve this objective, precluding a long-term, fixed-rate bond issue similar to the Series 1998 Bonds.

As noted above, the Series 1998 Bonds were "keepers." Hillsdale's financial improvement enabled it to adhere to the quantitative tests for incurring parity debt, one reason for delaying the issuance of the Series 2011 Bonds until after the FY2011 audited financial statements had been released. A more profound constraint turned out to be several ambiguities in the archaic Series 1998 Bond documents. A majority of the outstanding Series 1998 Bonds had become insured on the secondary market by a bond insurer which subsequently experienced financial distress and had entered run-off. First River Advisory observed that because this bond insurer would take extraordinary measures to force Hillsdale to refund the Series 1998 Bonds, it would not be possible to obtain any consents to document amendments. First River Advisory coaxed the Bond Trustee into approving several amendments without Series 1998 Bondholder consent that facilitated the issuance of the Series 2011 Bonds.

Two characteristics of the HELP Loans proved to be challenges as well:

1. certain covenants imposed by the credit bank; and

2. the August 2011 expiration of the credit facilities, unless extended by the bank.

The credit bank limited Hillsdale's total debt to $25 million, insufficient to encompass the principal amounts of Series 1998 Bonds still outstanding, of the Series 2011 Bonds to be issued and of the outstanding balances of the HELP Loans themselves. This covenant, together with other constraints, necessitated the refinancing of the HELP Loans, despite their favorable interest cost. When it became apparent that the Series 2011 Bonds would not be issued by the end of FY2011, First River Advisory arranged for a temporary extension of the credit facilities.

DEVELOPMENT OF THE FINANCING PLAN

First River Advisory's development of the Financing Plan balanced Hillsdale's cost constraints and risk tolerance with Hillsdale's financial capabilities and market realities. After its consideration of numerous alternatives, the Hillsdale Board adopted a Financing Plan featuring the following key characteristics:

- a direct purchase of tax-exempt Series 2011 Bonds by a bank or bank affiliate for a term of at least five years and amortizing over at least 20 years;

- a principal amount of Series 2011 Bonds sufficient to finance the projects and refinance the HELP Loans, which turned out to be $22 million;

- a variable interest rate indexed to LIBOR (rather than the riskier bank's cost of funds);

- a synthetic fixed rate produced by an interest rate swap for as long a term as possible, subject to a 6.50 percent all-in interest rate, on at least the eighty percent of Series 2011 Bonds earmarked for the project financing (the balance was earmarked for the HELP Loans refinancing, with respect to which Hillsdale was already exposed to interest rate risk);

- a parity security interest in the collateral already pledged to the Series 1998 Bondholders, supplemented by a mortgage on Hillsdale's main campus to be shared by all Bondholders; and

- recognition of the separate collateral already granted to the bank which issued the line of credit relating to the guarantee of the MOB loan.

First River Advisory drafted a Credit Profile that was sent to several banks along with an invitation to propose. At first, one bank emerged with a proposal that seemed to satisfy these objectives. After lengthy negotiations following the delivery of its commitment, the Hillsdale Board, upon the recommendation of First River Advisory, rejected this commitment, even though there was no viable "Plan B" at the time.

First River Advisory has found that its early and regular involvement in the project planning, design and engineering processes results in a better coordination with the financing activities. Early on, First River Advisory took control of the project budget and ensured that there were no unbudgeted costs. First River Advisory regularly collaborated in discussions of project cost reduction strategies, during one meeting pointing out that the planned pneumatic tube system seemed to be 20th century, rather than truly modern technology. Hillsdale management concurred and eliminated this component, thereby reducing the project cost by $100,000. First River Advisory also prepared the capital financing sections of CON amendments in a manner that facilitated rapid approval.

IMPLEMENTATION OF THE FINANCING PLAN

After the Hillsdale Board rejected the first bank's credit commitment, First River Advisory swiftly redoubled its efforts to attract another bank. First River Advisory performed exhaustive comparative analyses on the two proposals submitted and presented its findings to Hillsdale's Board in an easy-to-understand fashion. After the Board selected one bank's proposal, First River Advisory conducted extensive negotiations with the bank and its counsel. The outcome of these negotiations featured several far more favorable provisions than what the bank originally proposed:

- amortization over a 25-year period, longer than the twenty years specified in the Financing Plan;
- two dates during the original five-year term at which Hillsdale could formally request an extension of the term, leaving ample time to find an alternative financing source if such requests were denied;
- no real estate appraisal required;
- no impact on the interest rate due to a deterioration of the bank's credit quality;
- liberalized events of default generally, and in particular the elimination of an event of default for "material adverse changes" to Hillsdale's operations or financial condition;
- more manageable thresholds for the days' cash on hand and debt-to-capitalization ratio covenants;
- a loophole in the bank's limitation on the incurrence of additional debt;
- carve-outs from the bank's limitation on loans, advances and guarantees to unaffiliated persons and organizations; and
- the alignment of other covenants and reporting requirements with those already applicable to the Series 1998 Bonds.

The resultant Series 2011 Bonds adhered to all of the parameters specified in the Financing Plan, and even exceed some.

To manage interest rate risk, First River Advisory collaborated with a swap advisory firm to structure an interest rate swap. The bank which purchased the Series 2011 Bonds also submitted the best proposal for the swap. Because the bond counsel which had been involved in the issuance of the Series 1998 Bonds would not render a favorable opinion on this arrangement, First River Advisory had the foresight to recommend, in March 2011, that a different bond counsel with a favorable outlook on the matter, be engaged for this financing. The swap featured the following key provisions, all of which were at least consistent with the Financing Plan and some were better:

- a notional amount of $22 million, the same as the principal amount of the Series 2011 Bonds and greater than the minimum eighty percent attributable to the project financing that was specified in the Financing Plan;
- an all-in synthetic fixed rate of 5.37 percent during the five-year initial bank term, well beneath the Financing Plan limit of 6.50 percent;
- a swap termination date in 2036, the same as the final maturity of the Series 2011 Bonds, affording Hillsdale a high degree of, albeit not complete, long-term interest rate protection;
- periodic options for Hillsdale to terminate the swap at par, the first of which coincided with the bond term extension requests;
- no collateral posting requirements;
- avoidance of an additional termination event relating to a downgrade of Hillsdale's S&P rating; and
- implementation of Hillsdale's right to set-off payments to the bank as the holder of the Series 2011 Bond in the event that the bank, as swap counterparty, failed to make required swap payments to Hillsdale.

First River Advisory also devised a mechanism to capitalize interest on the Series 2011 Bonds during the project development period at the swap rate and arrange the monthly cash flows to settle payments on the bonds and the swap in an efficient manner. As part of its continuing services, First River Advisory performed the required calculations monthly, and prepared a certificate on behalf of Hillsdale.

From its experience in dealing with S&P when clients had issued bonds purchased directly by banks, First River Advisory advised Hillsdale that the issuance of the Series 2011 Bonds could result in a downgrade of S&P's rating on the Series 1998 Bonds, despite Hillsdale's greatly improved financial metrics. Because consent of the Series 1998 Bondholders could not have been obtained, it became essential to forestall any adverse rating action which might have influenced the Bond Trustee. First River Advisory deliberately delayed S&P's annual rating update until after the

Series 2011 Bonds were issued, the cornerstone of which was the Bond Trustee's acceptance of the certificates and opinions delivered by Hillsdale to qualify the Series 2011 Bonds as *bona-fide* "additional bonds" under the Series 1998 Bond documents. After the issuance of the Series 2011 Bonds, S&P affirmed the "BB+" rating on the Series 1998 Bonds and preserved the stable outlook.

SERIES 2012 BONDS

First River Advisory's routine monitoring of market conditions resulted in the identification of an opportunity to refund some of Hillsdale's Series 1998 Bonds without increasing its exposure to risk. Because the 2018 maturity of the Series 1998 Bonds was non-callable, those Series 1998 Bonds could not be refunded efficiently. First River Advisory overcame several quantitative and logistical challenges presented by the partial redemption of the remaining Series 1998 Bonds.

The Series 2012 Bonds featured a fixed interest rate through their final maturity in 2025. The Series 2012 Bonds amortized according to a tailored schedule which meshed well with Hillsdale's other outstanding indebtedness at the time, thereby minimizing the impact on its Maximum Annual Debt Service. The transaction resulted in the present value savings of $377,000, representing 6.6 percent of the principal amount Series 1998 Bonds that were refunded. This level of savings was remarkable, given that the Series 1998 Bonds had been issued under highly favorable market conditions.

In skillfully negotiating terms, conditions and covenants associated with a financial institution's commitment to purchase the Series 2012 Bonds, First River Advisory successfully avoided many of the pitfalls that are common in these direct purchases:

- no "material adverse change" (MAC) clause;
- no "most favored nation" clause; and
- no provisions for modification of the fixed rate if any of the following circumstances were to occur:
  - ☞ interest on the Series 2012 Bonds shall have been declared to be taxable;
  - ☞ the Bondholder shall have become subject to increased regulatory charges;
  - ☞ marginal tax rates applicable to the Bondholder shall have changed; or
  - ☞ Hillsdale's credit rating shall have been downgraded.

As a result, the risk profile of the Series 2012 Bonds is of far less concern than many other direct purchases.

First River Advisory led the effort to unwind a TIP Agreement relating to the investment of the Series 1998 Debt Service Reserve Fund while preserving Hillsdale's above-market return. Hillsdale subsequently sold the U.S. Treasury securities delivered by the TIP Agreement provider in connection with its unwinding and invested the proceeds in an FDIC-insured Certificate of Deposit. As a result, Hillsdale was able to record an immediate $53,000 gain, and realized an additional $6,000 on a present value basis over the remaining term of the TIP Agreement.

SERIES 2013 REFUNDING BONDS

While the yield on the Series 2011 Bonds complied with Hillsdale's affordability parameters, the associated risks were only marginally tolerable to Hillsdale's risk-averse Board. Hillsdale would have preferred a series of long-term, fixed-rate (LTFR), fully-amortizing bonds, but their yield would have been in excess of seven percent at the time, well above Hillsdale's affordability parameters. By the third calendar quarter of 2012, the market for LTFR hospital bonds had improved significantly. Based on its close observation of market conditions, First River Advisory estimated that a series of LTFR bonds could be sold at an all-in True Interest Cost (TIC) of less than six percent, taking into account the amount that would be necessary to terminate the "underwater" interest rate swap. First River Advisory presented its findings to Hillsdale management and, in September 2012, to the Board. The Board directed management and First River Advisory to continue to explore this concept.

Work on the Series 2013 Refunding Bonds began in earnest as the issuance of the Series 2012 Bonds was nearing completion. In December 2012, First River Advisory presented a more refined estimate to the Board of an all-in TIC of 5.494 percent. First River Advisory was able to quantify the cost of the avoiding the risks associated with the Series 2011 Bonds, often a challenging task. If the 5.37 percent synthetic fixed rate on the Series 2011 Bonds were to remain constant beyond the 2016 mandatory tender date through final maturity in 2036, then debt service on the LTFR Series 2013 Refunding Bonds would have cost Hillsdale approximately $1.8 million more on a present value basis. However, if the synthetic fixed rate on the Series 2011 Bonds were to increase by 50 basis points in 2016 (the interest rate swap was not sufficiently robust to hedge interest rate risk completely, a source of discomfort among Board members), then the cost would be reduced to $1,057,000. First River Advisory calculated the "break even" at 120 basis points – an increase in the synthetic fixed rate of more than 120 basis points in 2016 would have resulted in the LTFR Series 2013 Refunding Bonds having the lesser present value debt service. The Hillsdale Board judged that these were acceptable costs to avoid risk, and directed management and First River Advisory to proceed according to a timetable which called for the Series 2013 Refunding Bonds to be issued in March.

First River Advisory has found that risk-aversion / risk-tolerance varies among hospital boards. First River Advisory has observed that unsolicited financing proposals submitted to hospitals from investment banking firms contain definitive recommendations that are highly unlikely to reflect those differences because bankers would not have had the opportunity to "get to know" the organization. First River Advisory's comprehensive engagements are designed to elucidate all factors which are important in an organization's decision-making, especially those such as the risk parameters which cannot be gleaned from available data. Even if a financing solution seems clear-cut, First River Advisory will typically point out the benefits, costs and risks of alternative solutions to ensure that the obvious solution is the right solution. This validation process reflects the thoroughness of First River Advisory's approach, and ensures that the selected solution is the "right" one for that client under its particular set of circumstances.

First River Advisory had observed that many contemporary hospital bond issues seem to have been thrown together haphazardly or even sloppily, containing Preliminary Official Statement (POS) disclosure which barely meets legal standards. Many hospitals' investment bankers and financial advisors seemed complacent to "hit the average" bond yield as an indicator of success, unwilling or unable to "push the envelope" to do better. First River Advisory recommended that Hillsdale take an approach designed to enhance the marketability of the Series 2013 Refunding Bonds, resulting in a lower yield, yet without compromising other objectives. Measures included:

- assembling a top-flight team of professionals and challenging them to "think outside the box" and "leave no stone unturned;"

- delaying the timetable by two weeks to allow for the completion of Hillsdale's routine mid-year review of contractual allowance and professional liability reserves to validate the interim financial statements to be included in the POS;

- beefing up disclosure to encompass "every question ever asked" by bond analysts so that investor calls and site visits could be devoted to more probing questions rather than the response to basic questions and the collection of fundamental data;

- including in the POS management's financial projections (with appropriate disclaimers) which are routinely requested by bond analysts but usually provided outside the POS;

- conducting comprehensive on-site due diligence by the investment banker and its legal counsel;

- offering collateral, security features and covenants consistent with those contained in the *Recommended Term Sheet and Legal Provisions for Hospital Debt Transactions* issued by the National Federation of Municipal Analysts (NFMA) and with market expectations;

- offering "best-practice" continuing disclosure, including quarterly management's discussion and semiannual conference calls;

- building into the timetable two days just prior to releasing the POS during which there would be no activities scheduled other than for everyone on the financing team to "stop and think" for the purpose of ensuring that everything possible has been done to comply with disclosure requirements and to enhance the marketability of the Series 2013 Refunding Bonds.

The POS relating to another high-yield hospital bond issue brought to market in April 2013 had to be supplemented three times before those bonds were sold, a situation which these measures were designed to avoid. All three "stickers" related to matters which would have been addressed in Hillsdale's POS.

Events had progressed to within days of releasing the POS when the bank which owned the Series 2011 Bonds submitted a proposal to purchase Series 2013 Refunding Bonds which was vastly superior to its two previous proposals. Upon receiving this proposal on the day prior to the day on which the Hillsdale Board was scheduled to consider an authorizing resolution for the LTFR Series 2013 Refunding Bonds, First River Advisory calculated that proceeding with the LTFR Series 2013 Refunding Bonds would have cost Hillsdale an additional $4.4 million in debt service on a present value basis, nearly 2½ times the original estimate. First River Advisory immediately alerted Hillsdale management that the bank's latest proposal had merit and deserved consideration. The Board then suspended consideration of the LTFR Series 2013 Refunding Bonds so that the bank's proposal could be refined and converted into a firm commitment.

During the course of negotiations, First River Advisory negotiated concessions from the bank beyond those which applied to the Series 2011 Bonds:

- fixing a definitive interest rate on the Series 2013 Refunding Bonds for the 1½ months between commitment and closing, during which Hillsdale would still be able to receive the benefit of rate decreases but not increases (the interest rate at commitment was reduced by seven basis points at closing);

- eliminating the opportunity for the bank to increase the interest rate on the Series 2013 Refunding Bonds due to legal or regulatory changes, including changes in the bank's income tax bracket;

- after having found that the bank's "make-whole" is really a "make-windfall," applying an index of Baa/BBB hospital revenue bond yields, rather than U.S. Treasury security yields, as the discount rate in prepayment penalty calculations (a feature which proved its value in 2016);

- improving Hillsdale's ability to incur additional debt without the bank's consent; and

- accruing interest on the basis of a 30/360 day count rather than an actual/360 day count, the bank's usual practice which applied to the Series 2011 Bonds.

In negotiating the amount to terminate the interest rate swap, First River Advisory found that the bank, as swap counterparty, had been disregarding the value of Hillsdale's put options because it was too difficult to quantify. Rejecting this rationale, First River Advisory challenged the counterparty to perform the calculations properly. The outcome was a reduction of the termination amount by over $100,000.

After the direct purchase by the bank of the Series 2013 Refunding Bonds in April 2013, First River Advisory drafted and circulated a material event notice which conformed to the *Considerations Regarding Voluntary Secondary Market Disclosure About Bank Loans* white paper which was then just about to be released in final form. Shelley Aronson of First River Advisory served as a key member of the task force, spearheaded by the NFMA and the National Association of Bond Lawyers, which developed this white paper.

2014 AND 2015 DEFAULT WORKOUTS

Hillsdale failed to comply with a financial covenant applicable to the Series 2012 Bonds and Series 2013 Refunding Bonds during its FY2013Q4. Because the principal source of this non-compliance was a unique and untimely event, First River Advisory was able to devise a solution acceptable to the bondholders. First River Advisory also crafted an alternate calculation methodology that would apply to the first three quarters of FY2014 so that FY2013 audited financial statements could be released with an unqualified opinion and without the outstanding Series 2012 Bonds and Series 2013 Refunding Bonds reclassified as current liabilities.

More serious financial issues during FY2014 caused Hillsdale to fail to comply with financial covenants precipitating events of default relating to all three series of outstanding bonds. To address this non-compliance, First River Advisory drafted a Request for Proposals for a consulting firm based on its close collaboration with Hillsdale management to define the scope of the consultant's services. First River Advisory solicited and evaluated the proposals. The consultant was engaged subsequently, and First River Advisory has provided comments on draft reports. As the consulting engagement neared completion, First River Advisory negotiated a forbearance agreement relating to the defaults and the release of Hillsdale's FY2014 audited financial statements without an adverse audit opinion.

DEFEASANCE OF THE SERIES 1998 BONDS

During the course of the workout of the FY2014 defaults, it became apparent to Hillsdale and First River Advisory that the beneficial owner of the Series 1998 Bonds, by far the investor with the least credit exposure, was causing the most difficulty in fashioning a solution. First River Advisory had pointed out to Hillsdale months earlier that this obstacle could be eliminated by defeasing the non-callable Series 1998 Bonds. To accomplish the defeasance so that the Series 1998 Bonds would no longer be considered outstanding, First River Advisory:

- calculated that Hillsdale's cash deposit to the defeasance escrow would be the equivalent of approximately ten days cash on hand, so Hillsdale would not be in jeopardy of failing to comply with its liquidity covenant;
- collaborated with the Trustee to resolve logistical and timing issues;
- arranged for the liquidation of the certificate of deposit held in the Series 1998 Debt Service Reserve Fund;
- optimized the cost of the U.S. Treasury securities that would fund the defeasance escrow and arranged for their purchase;
- arranged for an accountant's verification of the sufficiency of the defeasance escrow;
- requested the withdrawal of Standard & Poor's rating on the Series 1998 Bonds; and
- resolved accounting issues relating to the extinguishment of debt.

Negotiation of forbearance agreements with the beneficial owners of the Series 2012 Bonds and the Series 2013 Refunding Bonds, together with other matters relating to the default workout proceeded more expeditiously and less contentiously with the beneficial owner of the Series 1998 Bonds no longer in the picture.

2016 ACTIVITIES

Hillsdale again failed to comply with its debt service coverage ratio covenant for the quarter ended December 31, 2015. To reduce its debt service obligations, First River Advisory calculated that Hillsdale could redeem its Series 2012 Bonds without unduly jeopardizing compliance with its liquidity covenant. First River Advisory spearheaded the effort to have the Bond Trustee "stand down" and defer to the wishes of the Bondholders.

2016 REFINANCING

First River Advisory applied an innovative financing technique developed for another client to refinance of all of Hillsdale's outstanding debt at an unprecedented 2⅜ percent fixed rate for thirty years, without balloon payments or other risks. Hillsdale formed an affiliated company, Headwaters Health Foundation, to acquire Hillsdale's real and personal property. Hillsdale applied the proceeds of the asset sale toward the debt refinancing.

First River Advisory assisted Headwaters file an application with the U.S. Department of Agriculture's Rural Development Administration (RD) for a Community Facilities Direct Loan (the CF Loan) to finance the acquisition. In connection with the CF Loan application, First River Advisory:

- supplied assumptions for and reviewed drafts of a financial feasibility study;
- collaborated with legal counsel in the drafting of an operating agreement between Hillsdale and Headwaters whereby Hillsdale would remain responsible for hospital operations, hold licenses and accreditations, employ staff and contract with third-party payors, clinicians and vendors; and
- facilitated RD's review.

Once the CF Loan was approved, First River Advisory played a pivotal role in closing the CF Loan, encompassing its calculation of prepayment amounts, coordination of the financial logistics for the closing among the attorneys, the title company, the lenders and the trustee for the Series 2013 Refunding Bonds, and preparation of intricate flows of funds statements that were reconciled against the title company's closing statement. First River Advisory's efforts produced distinct financial benefits to Hillsdale and Headwaters:

- prescient negotiation of the discount rate used to calculate the prepayment penalty associated with the Series 2013 Refunding Bonds (which represented most of the debt being refinanced) resulted in a zero prepayment penalty; and
- collaboration with legal counsel to reduce the title insurance premium and the real estate transfer tax which, together with other fine-tuning of the quantitative analyses, enabled the principal amount of the CF Loan to be reduced by $480,000 less than the amount approved by RD.

REFERENCE:

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