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Client Spotlight

Munising Memorial Hospital

$10,000,000
City of Munising Hospital Finance Authority
Hospital Revenue Refunding Bonds, Series 2012

$2,920,000
2012 Term Loan

$9,000,000
U.S. Department of Agriculture, Rural Development
Community Facilities Direct Loan (2016)

In early July 2011, First River Advisory received an urgent call from the Chief Executive Officer of Munising Memorial Hospital (MMH) upon the recommendation of a long-standing First River Advisory client. MMH operates a critical access hospital (CAH) in a small town on the shore of Lake Superior in Michigan's Upper Peninsula. The CEO had just received a notice from the bond trustee that a letter of credit (LOC) was about to expire, and the investment banking firm which had arranged that financing was nowhere to be found. This LOC backed bonds issued in 2006 to finance a facility replacement project. Its expiration date was in September 2011, but the trustee needed a renewal to be in place by late July to avert an extraordinary redemption of over $13 million of bonds, well beyond MMH's capability to fund.

LOC Renewal

First River Advisory swung into action immediately. Without ample time to arrange for a replacement LOC or alternative financing, First River Advisory focused on a renewal of the existing LOC by its issuing bank. Within three hours of the initial telephone call with MMH, First River Advisory had sized up the situation and arranged a conference call with the banker for the next day. In addition to the short time frame, arranging for the renewal was hampered by several other complicating factors:

1. MMH had failed to comply with its financial covenants after its fiscal year (FY) ended March 31, 2009, and was still experiencing financial difficulty through its FY2011;

2. the LOC bank is the domestic affiliate of a Spanish bank which had issued a confirming LOC, which the Spanish bank desired to discontinue;

3. MMH and the LOC bank had entered into an interest rate swap (the Swap) under which MMH's payment obligations had been theretofore unsecured, but the bank

now wanted to secure them on a parity with MMH's payment obligations on the bonds;

4. MMH had not had legal counsel regularly involved in its affairs, so it was necessary to engage a knowledgeable attorney and educate him or her swiftly; and

5. the banker who had just recently inherited the relationship had virtually no familiarity with MMH (didn't even know where MMH is located), had no ownership of the original financing and had little experience with hospital financing in general.

Despite these obstacles, First River Advisory convinced the bank that renewing the LOC would be in its best interests, supplemented by First River Advisory's demonstration of its record in completing the toughest financings. First River Advisory negotiated an LOC renewal that bought MMH up to another year to arrange a replacement LOC or alternative financing, with incentives for doing so earlier, and addressed the swap-related issues. First River Advisory delivered a report to MMH's governing board three weeks after the initial contact, and the transaction was concluded the following day – 22 days, start to finish.

SERIES 2012 BONDS AND 2012 TERM LOAN

With the heat off, First River Advisory could then focus attention on the arrangement of a replacement LOC or alternative financing. Two cornerstone processes were commenced immediately:

1. preparation of a comprehensive Credit Profile for use by lenders and investors in their evaluation of MMH's credit characteristics and investment merits; and

2. collaboration with the City of Munising's bond counsel to organize a local Hospital Finance Authority which would be essential if the solution were to involve the direct purchase by a bank of tax-exempt "bank-qualified" (BQ) bonds.

First River Advisory also assisted MMH to develop a successful appeal to Blue Cross Blue Shield of Michigan for increased reimbursement.

First River Advisory also commenced its identification of all possible financing solutions. During the course of this process, First River Advisory encountered other issues which needed to be addressed:

- the replacement of MMH's retired chief financial officer by an seasoned financial executive, but one who had neither hospital nor capital financing experience;

- the continual deterioration of the credit quality of the Spanish parent bank, causing the weekly interest rate on MMH's bonds to be reset as much as 162 basis points over the commonly-used index for such bonds, adding to the stress on MMH's income statement;

- the continual decrease in the valuation of the interest rate swap which, coupled with MMH's weak financial performance, caused MMH's fund balance to become negative by the end of its FY2012; and

- the discovery that MMH's (now former) auditing firm, which had also been engaged to complete MMH's Medicare cost reports, had been including MMH's swap payments as costs eligible for reimbursement, contrary to Medicare rules, causing even further financial stress.

Over the course of several months, First River Advisory determined that none of the following financing approaches would represent a viable solution:

- HUD Sections 242 / 223(f) mortgage loan insurance for refinancings;

- USDA Rural Development Community Facilities and Business & Industry direct loan and loan guarantee programs;

- replacement of the LOC by another bank's LOC;

- direct purchase of BQ bonds by one or more banks;

- conventional mortgage loans extended by one or more banks; and

- direct purchase of tax-exempt bonds by high-yield investors.

With all alternatives having been exhausted, First River Advisory challenged the LOC bank to become part of the solution. Having no better choice, the LOC bank became more of a partner, rather than an antagonist, to fashion an acceptable, though still temporary solution.

First River Advisory negotiated a solution involving the LOC bank's direct purchase of the Series 2012 Bonds and its extension of the 2012 Term Loan. This format eliminated the risk to MMH of further credit deterioration of the Spanish parent bank. The greatest benefit to MMH was the four-year term, set to match the remaining term of the Swap, which would resolve the Swap's negative valuation in due course. In addition, the transaction reduced MMH's all-in interest rate and provided relief from certain covenants.

PERMANENT SOLUTION

In late 2014, First River Advisory observed the convergence of several factors, most notably favorable conditions in the institutional high-yield bond market and MMH's better financial performance. MMH accepted First River Advisory's recommendation to proceed with the refunding of the Series 2012 Bonds and the 2012 Term Loan at the time rather wait until 2016.

First River Advisory presented to the MMH governing board the choice the between a series of long-term, fixed-rate (LTFR), fully-amortizing bonds to be purchased directly by an institutional high-yield investor or limited-term bonds to be purchased by a bank. MMH preferred to avoid the "balloon" payment and related risks associated with the bank financing and opted for the riskless LTFR bonds despite their higher cost. The MMH governing board appreciated First River Advisory's quantification of the cost associated with the avoidance of risk.

During the course of investigating permanent financing from private-sector sources, MMH's credit quality deteriorated. Though not designed for a complete refinancing, First River Advisory devised a variation on the USDA Rural Development Community Facilities Direct Loan program to enable the permanent refinancing of the Series 2012 Bonds and the 2012 Term Loan.

Following First River Advisory's recommendation, MMH formed a separate non-profit company, Munising Bay Healthcare (MBH) to acquire MMH's real and personal property. First River Advisory assisted MBH in filing an application with the USDA's Rural Development Administration (RD) for a Community Facilities Direct Loan (the CF Loan) to finance the property acquisition. In connection with the CF Loan application, First River Advisory:

- supplied assumptions for and reviewed drafts of a financial feasibility study;
- managed the State and Regional Clearinghouse intergovernmental review process;
- obtained a waiver of the State Historic Preservation Office's Section 106 Review;
- collaborated with legal counsel in the drafting of an operating agreement between MMH and MBH whereby MMH 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.

The proceeds of MBH's CF Loan were applied toward the acquisition of real and personal property from MMH. MMH, in turn, applied the proceeds of its property sale toward the repayment of its outstanding debt instruments.

Contemporaneously, First River Advisory negotiated a solution with the financial institution which held the Series 2012 Bonds, extended the 2012 Term Loan and served as the Swap counterparty. The financial institution took a "haircut" of nearly $2 million, representing over 17 percent of the aggregate amount owed. First River Advisory managed an iterative process involving the financial feasibility consultant to balance the financial institution's "haircut" and an MMH cash contribution so that the CF Loan would be determined to be financially feasible. A key factor in gaining the financial institution's cooperation was First River Advisory's pledge to limit the "haircut" request to the amount necessary to result in financial feasibility and to refrain from inflicting any unnecessary pain. Though not the classic example of a "public-private partnership," RD cited the financial institution's "partnership" as a compelling factor for the approval of the CF Loan.

While the CF Loan was approved in late September 2015, closing was postponed until February 2016 due mainly to delays at RD's Office of General Counsel. During this extended period, First River Advisory maintained regular communications with the banker representing the financial institution so that she could manage internal processes effectively.

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 and the financial institution, and preparation of intricate flows of funds statements that were reconciled against the title company's closing statement. Because First River Advisory's commercial bank was the same as that used by MMH/MBH, First River Advisory was able to expedite the movement of funds at closing.

Reference:

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