Selecting the Right Capital Project Financing

A Guide for Health Center Staff and Boards

Prepared by Capital Link

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Capital Link is a national, non-profit organization dedicated to assisting community health centers in accessing capital for building and equipment projects. From market feasibility and program, staff and facility plans to comprehensive financing assistance, Capital Link provides extensive technical assistance to health centers to assist in strengthening their abilities to plan and carry out successful capital projects. Additionally, Capital Link provides targeted loans to assist health centers in leveraging other sources of capital and works in partnership with primary care associations, consultants and other entities interested in improving access to capital for health centers.

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Table of Contents

Introduction

Community Health Centers (CHCs) have historically faced significant challenges in trying to secure funding for new facility development, building expansion or renovation, and major equipment purchases. The issue of access to capital is especially timely at this writing, with the increased availability of federal grant capital through the American Recovery and Reinvestment Act (ARRA). Through ARRA, the federal government provided $1.5 billion for capital grants to CHCs, an unprecedented opportunity to serve more patients, stimulate new jobs, and meet the significant increase in demand for primary health care services among the nation's uninsured and underserved populations. Having the federal government provide this level of capital grant funding is a significant opportunity for health centers.

Although virtually every federally-funded health center received some ARRA grant funds for their smaller capital projects, access to a significant portion of the federal funding was only available through a highly competitive process. As a result, only a small portion of health centers were able to fund their projects solely through the ARRA grant funds. Of the 600-plus applications submitted, only 85 health centers received competitive grant funds for their projects and many of these must still complete financings to fully fund their projects. With so many projects left unfunded by ARRA, many CHCs are seeking cost-effective alternatives that will allow them to proceed with their capital plans.

In addition, recently enacted policies of federal health reform are also set to provide additional operating and capital money to community health centers. Beginning in fiscal year 2011 and continuing for the next five years, the health reform package contains a total of $11 billion in new funding for community health centers, $9.5 billion in funding to expand operational capacity and $1.5 billion in funding for capital needs. While the additional operating funding should allow health centers to grow to serve 40 million patients by 2015 — up from 20 million currently — the new capital funding will only provide a down payment on the facility needs of an expanded health care system. Clearly, health centers will need to obtain capital from a variety of sources to meet their needs.

The purpose of this manual is to help health centers consider the best mix of capital financing options for their projects. It includes a primer on health center capital financing, covering how to estimate debt capacity and details on specific financing sources for equity, debt, and credit enhancement. The different sections provide information on what factors are important in determining which financing options to pursue and how to compare those options given the health center's own particular needs.

To successfully fund a capital project, health centers typically follow the key steps outlined below.

Understand the Challenges: Given the uncertain economic climate, there are a number of barriers in obtaining funding from traditional lenders. Conversely, federal grant capital is more available now than ever before and represents an opportunity.

Evaluate How You Stand: In order for you and outside funders to feel confident with the feasibility of the project, you need to understand at the outset the amount of debt your health center can likely afford and the amount of grants and donations you can reasonably raise. To determine the best way to fill any financing gap, health centers will need to explore and compare all their options for incremental equity and debt financing.

Understand the Factors that Will Influence Your Financing Needs: Considering factors such as health center location, the funding designation and the expected size of your loan will lead you to your possible funding options.

Determine Your Financing Needs: Before approaching any funding sources it is important to determine the amount and types of financing needed for your project. By refining your project budget and developing a plan of finance, the health center will have the information necessary to evaluate the right combination of funding sources. In addition, as the credit markets tighten and/or different grant opportunities become available, you must continue to refine this plan of finance throughout the capital development process.

Explore Available Financing Options: This section includes suggestions to help a health center to evaluate possible sources of debt and equity finance. There are also methods of credit enhancement to strengthen your health center's ability to obtain affordable debt. In addition, information on how to conduct a numerical comparison of your financing options is included to assist health centers in making more complex decisions.

Know your Debt Capacity and Other Borrowing Requirements: Throughout the whole capital development process, you will need to be able to estimate both current and future debt capacity based on the project scope. A health center's debt capacity is one of the main determinants of its ability to borrow, but it is not the only determinant.

Drive the Process: It is essential when completing a complex capital project and utilizing multiple financing sources that the health center be the driver in the financing process. You should consider all the financing options that may be applicable to your project; not just the most obvious ones. Remember, it's not all about a low interest rate.

Part 1

Influencing Factors

Why Community Health Center Financings are Challenging

Health center capital projects are traditionally funded through a combination of equity and debt sources, yet Community Health Centers (CHCs) have difficulty securing financing due to a lack of cash reserves and limited debt capacity. The stumbling blocks are sketched out as follows:

The Lack of Equity

While the term "equity" can refer to the difference between fair market value and current indebtedness, it can also mean the cash that is put into a project. Throughout this resource manual, the term "equity" refers to the amount of cash that the health center can contribute directly to the project.

- CHCs have limited cash on hand because most provide care for low-income, underserved and uninsured populations. This business model results in slim operating margins and low cash reserves, not the 20% – 30% project equity traditional lenders require.
- Conducting a far-reaching capital campaign is difficult due to the lack of a wealthy donor base in the areas CHCs operate, lack of staff to organize a campaign, and the significant time required to raise funds in this manner. Grant support is challenging given the downturn in the economy and the fact that foundations have reduced resources from which to make charitable gifts.

Limited Debt Capacity

Health center finances and the current lending market also make it difficult to access the debt markets to augment the equity sources.

- Many health centers operate in more depressed economic areas, resulting in lower property values that limit the amount of collateral available for a loan.
- The typical CHC payor mix and the resulting slim profit margins make lenders uncomfortable with the health center's ability to repay a loan, especially if the CHC begins to encounter financial

difficulties. This financial structure also makes health care managers and boards reluctant to take on the burden of regular debt service payments.

- A large portion of a health center's revenue stream comes from government sources, which are subject to annual appropriations and potential funding cuts. Lenders prefer that organizations have diverse sources of revenue to reduce the reliance on any one payor.
- Many community health centers have little experience working with banks and most banks have limited understanding of what CHCs are and how they operate.

Given these realities, health centers must be creative in patching together funding from multiple sources. While many health centers focus on obtaining as much equity or "free money" as possible, it is important to recognize that avoiding debt may have a cost as well. Debt can extend a health center's ability to move ahead with its project in the near term and to pay for it over its useful life. However, debt is only a feasible option if a health center has the ability to secure the debt and can demonstrate to a lender that it can be paid back. To this end, health center management needs to understand its project's financing requirements and its current debt capacity in relation to the options for financing.

Choosing the Best Combination of Debt and Equity

The Need for Debt Financing

Determining how much debt must be borrowed and repaid over time is critical to the success of most capital projects. Many capital projects cannot proceed without obtaining long-term debt financing and/or short-term bridge loans. Debt financing is a tool that allows the health center to pay for the cost of the project over time, ideally tied to the useful life of the assets being financed. Obtaining the lowest cost and most flexible source of debt financing can greatly ease the financial burden that a capital project imposes on a health center's operations.

Considerations of Debt Financing

While debt does carry some additional cost, it can be a beneficial resource as part of a capital project. Including some form of debt as part of its project financing allows a health center to start construction before the completion of a lengthy capital campaign. Debt also allows a health center to stretch its cash reserves to complete a larger project than it could have completed on its own or complete multiple projects at the same time. Debt financing can greatly accelerate a health center's ability to accomplish its goals of providing increased access to patient care.

Debt financing can be used for project development costs including land purchase, construction, equipment and soft costs, which results in a hard asset that acts as security for the loan. The costs of financing may often be included in the financing and amortized over the life of the loan. Longer term debt financing is seldom available for operating costs.

The Need for Equity

The amount of equity in the capital project is determined by the difference in the amount of debt the health center can afford to carry over the long term and the overall cost of the project. Sources of equity may include a health center's cash reserves or several different types of grants or contributions. Because health centers operate with slim profit margins, most can only afford to borrow a fraction of the cost of a capital project. Therefore, many health centers undertake capital campaigns to raise the balance. With a greater amount of equity, a health center can lower the amount of debt needed, making it easier to repay debt and devote more funds to health care services.

Considerations of Equity-Funded Financing

Equity's major benefit is that it carries no interest expense or principal repayment. However, equity sources should not be considered "free." A significant amount of internal staff time is needed to cultivate donor relationships, prepare applications, and monitor grants. Note that many lenders require all cash reserves, grant dollars or equity funds to be used before a health center draws down its loan, to reduce the borrower's costs as well as the bank's risk exposure.

Equity for Start-up Working Capital Needs

All capital projects have start-up working capital needs. Many expenses must be incurred before operations begin. Staff must be hired and supplies ordered prior to starting operations. In addition, it takes time to receive patient visit reimbursement from insurance payors, so start-up working capital needs must be considered within the overall planning of the capital project. Equity can be utilized to cover start-up operations as most debt funds are only available to cover building and equipment costs. In some cases, health centers will boost their capital campaign goals to increase the amount of equity generated in order to cover some of the first year's operating expenses and other working capital items, such as rebuilding cash reserves or paying off short term payables.

The Factors that Influence Your Health Center's Financing

When initially evaluating financing options, the following factors will influence your health center's available financing options and choices. Ask yourself the following questions so you know the type of financing options available to you. More information about the financing options suggested is included in later sections.

Where Is the Center Located?

Health centers located in rural areas will have access to different options than urban health centers. There are also geographic designations by census tract or zone that may affect eligibility for different financing sources. Being located in an Empowerment Zone or a New Markets Tax Credit eligible area opens up additional possibilities.

Rural health centers located in areas with populations less than 20,000 should first consider the **USDA's Communities Facilities Program.** Through this program, some health centers can pursue grant funding for the equity portion of their project as well as direct loans with attractive interest rates and terms. For health centers facing financial challenges or loan-to-value issues, the USDA loan guarantee program is available. Generally utilized with a traditional bank loan, the guarantee induces a lender to make a loan and/or improve its terms.

If a health center is located in an **economically distressed area,** or Economic Development Administration-designated area, it may qualify for an **EDA grant.** In addition, health centers that are located in certain low-income census tract may be eligible for New Markets Tax Credit financing.

What Is the Health Center Funding Designation?

Section 330 Federally Qualified Health Centers (FQHCs) have access to funding sources and options for credit enhancement that are not available to non-Section 330 centers. **Section 330 FQHCs** are eligible to apply to the **Health Resources and Services Administration's (HRSA) Loan Guarantee Program.** The HRSA Loan Guarantee Program cannot be used with tax exempt bonds.

What Size of Loan is Being Considered?

The size of the loan will affect the cost effectiveness of different options as well as whom to approach for financing. The fees associated with some of the more complex low-cost financing vehicles require large loan amounts to make the financing method cost effective. In addition, some financial institutions have lending limits that affect their ability to provide a larger loan on their own. They may need to bring in another bank to participate, potentially increasing the cost.

Borrowing Need Greater Than $5 Million — Larger projects have the most options available, especially if you are seeking low-cost financing. Although upfront fees are generally greater for some of the more complex financing options, interest savings associated with larger projects as well as the financial benefits of particular financing programs can outweigh the up-front costs, many of which can be rolled into the project costs and amortized over the life of the financing. For projects greater than $5 million, the below-market rates offered by the following programs are attractive options:

- **New Markets Tax Credits (NMTC):** For NMTCs, projects must be located within an eligible area census tract and the overall organization will need to qualify as eligible.
- **Tax-exempt Bonds:** All types, including bank qualified, private placement, and public offerings, should be considered.

CHCs with larger projects could also approach either banks or Community Development Financing Institutions (CDFIs) for conventional loans. CDFIs, however, may have lower borrowing limits and may have to work with other CDFIs or banks to handle the complete financing need for larger projects.

Borrowing Need Less Than $5 Million — For smaller projects, the significant upfront cost of the more complex options may outweigh the benefit of a lower interest rate. The best options for debt financing for smaller projects tends to be loans through Community Development Financing Institutions (CDFIs) or conventional banks.

What is the Overall Cost of the Financing?

The total cost of the financing, whether it is the stated interest rate or the "all-in" annual expense, will vary among options according to the complexity of the deal. Conventional bank loans may have a higher annual interest rate, but do not have additional costs that may be included in more complex financing options such as a tax-exempt bond issuance, which typically include letter-of-credit, trustee, remarketing, bond ratings, or other issuance fees. For example, the stated interest rate for a tax-exempt bond issuance could be as low as 2.5%, but the real cost to the health center may be somewhat higher due to issance costs. When these fees are added in, the "all-in" rate could be almost as high as conventional financing. The "all-in" rate should be compared for each option.

Different financings will also require different covenants, such as prepayment penalties, restrictions on additional debt, or conditions on the amount and type of collateral. These covenants can greatly affect the attractiveness of a particular financing option and in many cases make more of a difference to the health center than the interest rate. For example, covenants that limit the amount of additional indebtedness or require an all asset lien, which may affect the health center's ability to borrow for future capital projects. These covenants could tie up all a health center's collateral for one project or limit a health center's ability to access other financing sources for subsequent capital projects. If a health center has plans for future expansion, it will need to evaluate all the covenants required by a particular financing option and not just the interest rate.

What is the Center's Credit Strength?

Depending on your health center's financial strength, you may need to arrange for credit enhancement to obtain debt financing. Health centers with a spotty financial performance, or those looking to obtain a much larger loan than they could have supported historically, based on financial projections, may need credit enhancement to boost the strength of their proposal.

If a health center has difficulty demonstrating adequate credit strength to lenders, it should consider options such as **HRSA's Loan Guarantee Program** and the **USDA Community Facilities Guarantee Programs.**

The health center can also look into getting a guarantee from a local hospital or other partner. For tax-exempt bonds, credit enhancement is available through a letter of credit from a bank.

Loan-to-Value Ratio Issues — Since health centers typically operate in economically depressed areas, many capital projects face difficulties in meeting the loan-to-value ratios required by banks. If a health center has difficulty providing sufficient collateral, it should consider credit enhancement such as: **HRSA's Loan Guarantee Program, the USDA Community Facilities Guarantee, a guarantee from a local hospital or other partner, or a letter-of-credit from a bank.**

What is the Length of Time of the Financing?

Most long-term financing mechanisms have two time periods to be considered: the amortization term and the loan term. The amortization term is the number of years over which the loan is repaid. The term of the loan is a shorter period of time that enables the bank to review the credit quality of the borrower and to make adjustments if needed.

As one of the goals of financing is to match the life of the asset with the financing, most health centers look for long amortization terms or periods, which can range from 15 years for conventional bank financing to 30 years for tax-exempt or USDA financing. For health centers conducting major construction or renovation projects, a longer amortization term could make debt repayments more manageable and better match the life of the building.

The loan term for conventional bank loans usually ranges form 3 to 10 years. The term enables the bank to conduct a credit review and adjust the pricing or terms of the loan, if necessary. These "renewals" usually involve a fee and legal expenses. The following are common examples of amortization and loan terms.

- **New Markets Tax Credits:** While the main term is seven years, most of these financings have long term debt amortization of over 20-to-30 years.
- **Tax-Exempt Bonds:** Many bonds have longer amortization terms in the 20-to-25 year range. However, the letter of credit associated with these bonds or any interest rate swap would have shorter terms of 3-to-5 years. To avoid letter of credit fees or renewals, consider a bank qualified tax exempt bond issuance, which would not require a letter of credit.

Is the Financing Occurring in Conjunction with a Capital Campaign?

Several financing options have limitations on prepayment of the loan. If the health center wishes to pay off some or all of the debt financing in conjunction with a capital campaign it is important to determine whether prepayment is possible when evaluating the options. The possibility of a capital campaign could affect a health center's choice of financing in several ways:

- **Resources for Additional Equity:** On the equity side, the health center may be eligible for a matching grant through the Kresge Foundation or other grant programs.
- **Prepayment Penalties:** On the debt side, a health center should consider the prepayment options available if the health center would like to pay off its long-term debt with capital campaign proceeds. Generally, New Markets Tax Credit financings do not allow principal repayment during the seven-year tax credit compliance period. Tax-exempt bonds also carry prepayment penalties during the "call" periods, particularly if they have been combined with an interest rate swap. If the floating rate has been swapped to a fixed rate, the health center will need to pay additional fees related to the swap in order to retire it early.

Determine Your Financing Needs

Refine the Project Budget

The first step in developing your capital project funding mix is to understand the total financing needed for the project by refining the total Project Budget. The Project Budget includes all the costs related to the project, including real estate or site acquisition costs, hard costs, equipment costs, costs related to financing and/or fundraising and other "soft costs." As the budget develops, it is essential to account for the passage of time and add estimates for additional costs related to any increase in construction costs, changes in interest rates, or increased usage of consultants as part of the refinement.

Develop a Plan of Finance

Once the Project Budget has been finalized, the health center needs to develop a Plan of Finance. The Plan of Finance identifies and quantifies the "Sources of Funds" for the capital project and represents the "funding game plan" going forward. The Plan of Finance must always be considered in the context of the Project Budget, which constitutes the "Uses of Funds." When developing the Plan of Finance, the health center will need to consider the costs and benefits of utilizing equity or grant funds versus taking on some level of debt for the project. The mix should be determined by the total project costs or expected debt load a health center expects it can afford. Typically health centers have a 50/50 split between debt versus equity, but this combination varies by the amount of reserves or grant funds a health center has already raised in relation to the relative affordability and variety of debt options in its area.

Debt Capacity Analysis and Lending Requirements

Understanding Your Ability to Borrow

Debt capacity is the amount of debt a health center can afford to take on, given its historical or projected financial position. When evaluating potential borrowers, lenders look at a health center's historical or projected operating performance in order to determine a range of debt the health center could feasibly service as part of a capital project. Debt capacity is estimated by first determining "Funds Available for Debt Service," which is defined as Net Income + depreciation + amortization + interest expense. This amount can then be discounted to reflect a standard debt coverage ratio requirement of 1.25, which provides a safety cushion for usual variations. This amount can then be used to estimate the amount of debt the available cash flow could support, given a specific interest rate and loan term. By doing this calculation, the health center can get a preliminary estimate of its debt capacity and better understand the "gap" it may need to fund through equity contributions and/or a capital campaign in order to complete its project.

Example:

A health center with net income of $300,000, depreciation of $345,000 and current interest expense of $32,000 would have Funds Available for Debt Service of $647,000.

$300,000 (net income)	+	$345,000 (depreciation)	+	$32,000 (current interest expense)	=	$677,000 (funds available for debt service)

This amount could further be discounted by 1.25x debt service coverage, leaving $517,600 of available cash flow for debt service.

$677,000/1.25 = $541,600

This available cash flow could service the following debt at various rates and amortizations :

- At 9% for 20 years: $4,944,020
- At 7% for 20 years: $5,737,718
- At 5% for 20 years: $6,749,533

= Present Value of (–541,600, 0.07, 20) = $5,737,718

This amount would then need to be compared to the health center's overall project cost in order to determine the gap. If this health center were looking to undertake a project with an estimated budget of $10,000,000 and was able to get 7% debt for 20 years, the gap in financing that the health center would need to raise through equity would be $4,262,282. It should be noted that the amount of equity decreases as the cost of the debt goes down. By keeping the cost of debt low, the health center needs to cover less of the project through equity because the health center can afford to take on more debt to cover the cost. This amount also reflects the total debt a health center can afford to take on. Any existing debt should be subtracted from this amount to determine the amount of new debt a health center can take on for this project. In addition, the health center has to determine its own level of comfort with debt and develop its debt capacity figures based upon what the health center expects its operations to look like in the future.

Debt capacity for a particular health center can vary over time. Debt capacity will fluctuate with the health center's operating performance or level of debt in a given year. Health centers that have a strong operating history with positive net income would have a stable debt capacity, while a health center that has fluctuated between operating surpluses and operating losses would experience large shifts in its debt capacity. Debt capacity should be evaluated as trend over time.

Because this method of estimating debt capacity relies on historical information, a health center could more accurately determine future debt capacity by carefully analyzing its market to establish realistic patient volume, revenue, and expense projections over the next 5+ years, and use the projections to determine the level of debt that the health center could realistically assume going forward. The projections should take into account the potential increased volume and revenue a capital project could generate, which would be additional income that could support a larger loan. In addition while conducting this analysis, it should also be noted that depreciation and interest expense on the proposed facility would be

ongoing expenses to the health center. These additional expenses should be included as part of the projections to help determine the overall debt capacity a new project could carry.

Lending Requirements

Lenders will look at a number of factors when considering extending debt, including collateral coverage, management experience, financial trends, leverage, competitive factors and whether the project itself makes sense. Depending on the structure of a lending organization, its mission and business strategy, the emphasis on specific lending criteria will vary. Lenders such as banks are regulated by state and federal regulatory agencies. The regulators not only evaluate the financial condition of the bank itself, but regulators examine the credit-worthiness of the loans that the bank has made and whether the bank is adequately reserved for those loans. In order to comply with regulatory requirements, a lender will do a thorough analysis of an organization. For a bond transaction, the structure and strength has to be sufficient to entice a bond purchaser to buy the bond. While bond purchasors will be interested in the fundamental credit strengths of the deal, they are not regulated and have more flexibility in credit structure. The lending criteria for organizations such as community development loan funds and alternative lenders is based on the mission of the organization. Because they are regulated differently, they also may have flexibility in their lending criteria.

The extension of credit is based on the belief that the borrower is willing and able to repay the loan. Sound lending requires the application of the Five Cs of Credit: Character, Capacity, Capital, Conditions, and Collateral. Character can be defined as management's integrity, both personal and professional, as well as management's ability to operate the organization successfully. Capacity refers to the ability to repay the proposed loan. Capital represents the availability of sufficient cash and credit to complete the project successfully. Conditions refer to the existence of competition, the nature and rapidity of technological change, as well as general economic conditions in the markets served. Collateral refers to the sale value of pledged property in the event of a problem. Lenders consider the key to lending successfully is to understand the nature of each prospective borrower well enough to apply these five credit essentials to each loan request.

PART 2:

Financing Options: Sources of Equity, Debt, & Credit Enhancement

Once a health center has refined its project budget, developed a plan of finance, and determined its debt capacity, it is now ready to evaluate the different options for establishing the financing plan. This section offers suggestions to consider for sources of equity, debt, and credit enhancement for health center capital projects.

Sources of Equity

Health Center Cash Reserves

A health center can invest its own cash reserves into its capital project, but should keep at least 30-to-60 days cash on hand in order to support ongoing operations. Utilization of its cash reserves for a capital project should not leave the center "cash poor" and unable to meet its day-to-day cash needs.

Grants and Sources of Grants

Grants are charitable donations, usually consisting of money, typically made to 501(c)(3) non-profit organizations to help them meet specific goals with regard to their strategic plan. They can also be resources provided instead of cash such as personnel, equipment, or space, all of which are referred to as in-kind donations. Charitable donations can come from individuals; private, corporate, community, and conversion foundations; corporations; and private businesses. Types and sources of grants include:

Federal Appropriations Grants are line-item appropriations obtained by a health center's legislators in support of its capital project. Federal appropriations for health care and other facilities may be used for construction, renovation, moveable equipment or design.

The American Recovery and Reinvestment Act (ARRA), offered through the Bureau of Primary Health Care, provided grants to health centers over two years. To promote job creation

and to provide increased access to care during the recession, the capital awards were provided through two programs: the Capital Improvement Program (CIP) and the Facility Investment Program (FIP). Through these programs $851 million was made available through CIP grants and $500 million was awarded in FIP grants to support construction, renovation and equipment (including IT) for health centers. For more information, visit **http://bphc.hrsa.gov/recovery.**

Community Development Block Grants (CDBG) is a U.S. Department of Housing & Urban Development (HUD) program administered through local governments. The State CDBG program provides states with annual direct grants that are in turn awarded to smaller communities and rural areas for use, among other things, in improving community facilities. The CDBG program has two components: 1) the State CDBG program, which provides the State with annual direct grants which the state in turn awards to smaller communities, and 2) the CDBG Entitlement Communities Program through which larger cities and counties receive annual grants directly from HUD. If the health center is located in an Entitlement Area or is located within a state with an eligible program, it would be eligible for funding from this program. For more information, visit **www.hud.gov/offices/cpd/communitydevelopment/programs.**

The Department of Commerce's Economic Development Administration (EDA) provides grant funding for economic development projects through its Public Works and Economic Development Facilities Assistance Program. Projects must be located within an economically distressed, Economic Development Administration-designated, eligible area and must fulfill a pressing need in the area. The basic grant rate may be up to 50 percent of the project's cost; in certain circumstances, the rate of federal contribution may be as high as 80 percent. While there is no statutory maximum or minimum grant size, a typical grant size is approximately $1 million. Additional information can be found at **www.eda.gov.**

The USDA Rural Housing Service Community Facilities Program provides small grants, typically less than 10% of total project size, direct loans up to $750,000 and up to 100% loan to value if a project is under $750,000, and loan guarantees of up to 90% of project financing, including soft costs rolled into the loan to assist in the development of essential community facilities and services in rural areas of up to 20,000 in population. Additional information on the USDA's programs can be found at **www.rurdev.usda.gov.**

The US Department of Health and Human Services (DHHS) / Administration for Children and Families / Office of Community Services Discretionary Grants Program (OCS) provides grant funding for projects that have a job creation component. The program is intended for community economic development initiatives that create new jobs for low-income people. The jobs need to be permanent and have career ladder opportunities within the health center. Centers receiving funds will be monitored for compliance with the job creation requirements. The program awards up to $15,000 per new job created, for a maximum

of $750,000, although OCS prefers to award funds in the $200,000 – $400,000 range. OCS is particularly interested in community health centers because centers are central economic forces in their communities. The health center would need to amend its articles of incorporation to include a new purpose: economic development and job creation. For more information about these grant programs, visit **www.acf.hhs.gov/programs/ocs/ced/index.html.**

Foundations, which are private, corporate, community and conversion organizations that provide financial support to non-profits to support their service missions, can be a source of grants. Some foundations operate on a national or international basis, but many limit their support to specific geographic regions and have particular fields of interest and stipulations about the types of support they are willing to provide.

- The Kresge Foundation is an example of a foundation that contributes money toward community health center capital projects through a **Matching Grant Program**. This program acts as an incentive for other donors to give money toward the project. Kresge Foundation grants are awarded based on the applicant organization's readiness to proceed with the specific capital project and the demonstrated ability of the applicant organization to secure broad-based community support. The Kresge Foundation requires that the Board of Directors be committed to giving to the project as the first step in the fundraising process. In addition to facilities-capital challenge grants, Kresge is also increasing its investment in community-based health centers through a variety of funding methods, including program-related investments or below market rate loans.

  Kresge has recently started a grant program that supports non-section 330 community health centers that are undertaking several initiatives. The **Health Clinic Opportunity Fund** provides grants to build the operational capacity of charitable health clinics, public-health clinics, and those designated as federally qualified health center look-alikes.

  For more information about Kresge's programs, visit **www.kresge.org.**

Fundraising Campaigns are coordinated long-term organizational efforts to garner financial contributions for a specific project or program. A campaign generally involves an intensive effort to meet a specific financial goal within a certain time period. The organization undertaking the fundraising campaign must plan and organize solicitations for funds from individuals, businesses, and private corporate, community, and conversion foundations. In general, up to 80% of all donations to fundraising campaigns come from affluent individuals. The success of a campaign is contingent on many factors, including the funding goal, the appeal of the project, the giving environment, the extent of the prospect research, and the health center's contacts within the philanthropic community.

Partnerships

Health centers can also approach local **hospitals or other partners** to provide equity funding for their capital projects. Most health centers have very good working relationships with local hospitals. Since hospitals often have more resources than health centers, they can be instrumental in the capital financing arrangements for certain health centers. In some cases, hospitals can award health centers "community benefit" grants for their capital projects, with virtually no restrictions other than approval of – but no control over – the capital budget and proof that the medically underserved community/populations served by the health center will benefit from the project. Many times, hospitals are willing to pay for a feasibility or market study associated with a health center capital project. If the study shows that the project can be successful, then the hospital may be willing to contribute money to a capital project, or sometimes add additional resources to help a health center afford a larger project. Sometimes the hospital partner will also donate the land needed for a new facility or lease the land to the health center for $1 for 99 years (effectively donating the land). A similar arrangement could be made with other types of local partners who may have additional financial resources to help health centers.

Sources of Debt

Conventional Bank Lenders

Conventional bank lenders provide market rate financing for all or a portion of a capital project. Conventional lenders willing to fund community health center capital projects are available both locally and nationally. In some cases, a health center can leverage a local banking relationship for lower rates, more flexible terms, and quicker turnaround. So, a health center should start its search for debt options by first contacting its own depository bank. A health center could potentially borrow more money or borrow at a lower interest rate, if it has a loan guarantee from a hospital partner, HRSA, the Bureau of Primary Health Care, or the USDA.

- The **benefits** of conventional loans are that they are **less complex** and can be relatively easy to structure and close. The shorter time frame could also make this option **less expensive** than below market options.
- The **costs** of conventional debt are the **market interest rates** and the **shorter loan terms.** Debt service (the interest and principal payments) is usually higher because of these factors.

Community Development Financial Institutions (CDFIs)

CDFIs are organizations that were created to expand the availability of credit, investment capital, and financial services in distressed urban and rural communities. A CDFI is a private-sector financial intermediary whose primary mission is community development. CDFIs can be development corporations, community development banks, credit unions, and micro-enterprise loan funds at the local and national level.

- The **benefit** of working with CDFIs is that they are specialized lenders working in a market niche historically underserved by conventional lenders. They often make loans and investments that are considered too risky by industry standards. They are also usually able to offer **flexible terms** and **structuring.**
- A **constraint** is that CDFIs typically fund projects of a **smaller** scale, making them a less attractive option for larger projects. However, if a health center has a larger project, a portion of the project funds could come from this source.

The following website provides more information about CDFIs and provides a list of CDFIs in your area: **www.cdfifund.gov**.

Quasi-public or Mission-based Loan Funds

These vehicles are loan funds targeted to special recipients, such as community health centers. Most are non-profits and are owned by a public agency, a bank, or even a CDFI. As specialized lenders working in a market niche, they often make loans and investments that are considered too risky by industry standards. They are also usually able to offer flexible terms and structuring. Because most of these loan funds rely on pooled resources, they may be able to offer advantageous terms to both smaller and larger projects.

Tax-exempt Bonds

Tax-exempt bonds are bonds issued by municipal, county or state governments, whose interest payments are not subject to federal, and sometimes state or local, income tax. Because the interest income from tax-exempt bonds is exempt from taxation, bond investors can offer lower-interest loans to certain types of eligible borrowers, including community health centers. The bonds can carry either a variable rate or a fixed rate. Most of these bonds are issued through state-based issuing authorities.

- The **benefits** of tax-exempt bonds are **below market interest rates** and **longer terms,** usually up to 25 or 30 years.
- The **constraints** are that tax-exempt bonds do have **higher transaction and legal costs** and are **more complex** to set up. The complexity could result in a **longer time to closing.**
- Bond issuances are most economically feasible for **larger projects.**

With the higher transaction costs, most stand-alone bond issuances are not economically feasible for loan amounts smaller than $5 million. For smaller projects, the up-front costs may outweigh the benefits, given that tax-exempt bonds require extensive legal documentation to comply with Internal Revenue Service (IRS) requirements. Some statewide issuers have developed special programs for smaller borrowers, including pooled bond programs, credit enhancement, or simplified programs that reduce the paperwork.

There are two primary types of bond issuances. Publicly offered bonds are resold on the secondary market, while private placement issues are sold to a pre-identified buyer. There is also a specific type

of private placement, called bank qualified bonds, where a bank buys and holds the tax-exempt bonds. Recently, the American Recovery and Reinvestment Act altered the rules for bank qualified bonds to allow borrowers with projects of up to $30 million to take advantage of this program, making these bonds a more viable option than in the past. In terms of complexity and cost of issuance, ranging from the least to the most expensive, a health center would consider first bank qualified bonds, a private placement, and then a publicly offered bond.

- **Publicly Issued Bonds** need to be "credit enhanced" with a letter of credit from a qualified bank or with bond insurance. This credit enhancement creates increased issuance costs associated with establishing the letter of credit or bond insurance as well as an additional annual fee. These bonds will often also carry remarketing fees, trustee fees, and ratings agency fees among others.
- **Bank Qualified Bonds** eliminate most of the above fees because the bank buys and holds the bonds. No letter of credit is needed, and many of the above fees can be avoided.

New Markets Tax Credits

In 2000, Congress passed legislation creating a new investment tax credit called New Markets Tax Credits (NMTC). This tax credit was designed to stimulate investment in low-income communities. Because many community health centers are located in NMTC eligible areas, they stand to benefit substantially from the NMTC program. The program is administered by the Community Development Financial Institution (CDFI) Fund under the U.S. Department of the Treasury. With the recent American Recovery and Reinvestment Act, the federal government has continued to extend this program and made available additional tax credit allocations.

NMTC allocations are competitively allotted to organizations called Community Development Entities (CDEs). CDEs are organizations that provide investment capital for low-income communities or persons. Using these tax credits, CDEs have created low risk investment opportunities for large-scale investors – banks, corporations, pension funds and high wealth individuals – to invest, through the CDE, in projects that strengthen and develop low-income communities. NMTC creates an incentive for large investors to invest in CDEs by offering them tax credits. The first three years of the investment period, investors receive tax credits equivalent to 5% of the "Qualified Equity Investment" (QEI) investment. In each of the next four years, they receive tax credits equivalent to 6% of the QEI. This tax credit gives investors a total savings on their tax liability of 39% over seven years. CDEs then use this money to lend or invest in prospects in low-income communities.

With this new influx of capital, CDEs have created NMTC-funded programs, such as fixed-rate or low interest rate loans. Through these programs, CDEs invest in the long-term projects of qualified low-income community businesses. Community health center capital projects are ideally suited for NMTC-funded programs, generally meeting the definition of qualified businesses under the NMTC legislation. Also, CHCs are typically located in low-income communities and generally require low-cost long-term financing for capital projects. A health center is considered to be eligible if it is located in a NMTC-eligible census tract and it generates at least 50% of gross income from doing business in a Low-Income

Community. Areas that qualify as Low-Income Communities either have census tracts with a poverty rate of at least 20% or have census tracts where the median family income is below 80% of the area's median family income.

The benefits to NMTC are as follows:

- The tax credit portion of most transactions adds **"near equity"** to the project, up to 25% in some cases. If a health center has grants for a project, it may be possible to structure these in ways to further leverage the value of the tax credits — in some cases virtually eliminating or limiting the health center's debt at the end of the tax credit compliance period.
- Loans are typically structured as **interest only** for the first seven years of the transaction.
- Many structures carry **below market interest rates** and **longer terms.**

The costs, however, of NMTC can be significant.

- NMTC loans do have **higher transaction and legal costs** and are **the most complex financing** to set up.
- The complexity could result in a **longer time to closing.**
- NMTC loans **cannot be prepaid** during the initial seven year period. Capital campaign funds that will be used for debt repayment will need to be invested during this time until repayment is allowed.

NMTC are most economically feasible for larger projects, usually those that exceed $5 million.

The following website provides more information about the NMTC program and provides a list of tax credit allocatees in your area: **www.cdfifund.gov.** Additional information can also be found at Novogradac's New Market Tax Credit Resource site at **www.novoco.com/new_markets.**

Community Facilities Program

The Community Facilities Program, a division of the USDA Rural Development Rural Housing Service, administers both direct loans and loan guarantees for projects located in rural areas and towns of up to 20,000 in population. Direct loans are available to public entities, non-profit corporations, or tribal governments and can be used for construction, expansion and renovation projects. The loan program offers three levels of interest rates on a fixed basis and usually has terms of 30 – 40 years. The direct loan program may also be combined with the USDA Community Facilities guarantee program. As part of the American Recovery and Reinvestment Act, the federal government has added an additional $1.2 billion in loans (and grants) for essential rural community facilities, making this program even more readily available than before.

- The **benefits** include below-market interest rates (4% – 5%) and longer terms (30 – 40 years) for direct loans.
- The guaranteed loans may provide loans at slightly below-market rates.
- A **constraint** is that the project must be located within a designated rural area.

Additional information on the USDA's programs can be found at **www.rurdev.usda.gov.**

Forgivable Loans from Hospitals or Other Partners

In this arrangement, the hospital or other interested partner lends interest-free money to a health center for its capital project. These loans are tied to certain criteria, typically clinical requirements that the health center has to fulfill. If the health center successfully meets the criteria, the loan is forgiven. For example, Capital Link has worked with health centers that have received 10-year forgivable loans from teaching hospitals. Under such circumstances, the health center has to fulfill certain criteria, such as performing a certain number of breast cancer screenings, setting up an asthma program, and other clinical initiatives. If the health center successfully meets the requirements, 1/10th of the loan is forgiven each year until it is fully paid off. If the health center fails to meet the requirements, the loan is considered to be in default and the center owes the money back to the hospital. In this arrangement, the forgivable loan acts as equity in the financing mix for the health center capital project.

Sources of Credit Enhancement

Credit enhancement is a method whereby a health center can enhance its credit worthiness when pursuing debt financing. Credit enhancement can improve a health center's ability to obtain a loan, lower the interest rate, and/or improve the loan terms. It is also useful in situations where a project's loan-to-value ratio is not sufficient for the type of debt pursued. Credit enhancement does add another player to the loan closing process and may also increase the number of steps and time it will take for the deal to close. However, credit enhancement can make the difference in getting the more difficult deals completed, which could far outweigh the additional complexity.

The HRSA Facilities Loan Guarantee Program is a $160 million loan guarantee program for facilities development and managed care networks and plans. The program provides an 80 percent guarantee on the principal amount of loans made by non-federal lenders for construction, renovation, and modernization of medical facilities that are owned by federally funded Section 330 health centers. The loans may be used for: land and building purchases, renovation and new construction costs, equipment and "fit-out" costs, a limited amount of debt refinancing (not to exceed 30% of the overall project), financing and consulting fees, capitalized interest during construction, and limited working capital during a start-up phase.

While land and equipment purchases are eligible costs, they are allowed only as part of a construction, renovation, or modernization project. Leasehold improvements are ineligible unless the health center has signed a long-term lease, usually greater than 25 years. Also, these guarantees are not eligible for tax-exempt bonds. They are, however, available for use in conjunction with New Markets Tax Credits.

- The **benefits** of HRSA's loan guarantee program is that it provides incentives to lenders to offer improved terms or reduced restrictions. It could result in **lower interest rates, better loan-to-value requirements,** or **lower debt service coverage covenants.**
- The **constraints** are that it is **only available to Section 330 health centers.** Many **lenders are less familiar** with the program and it has **one extra layer of approval.**

For more information visit **http://bphc.hrsa.gov/policy/pin9720.htm.**

The USDA Community Facilities Guarantee Program provides guarantees on loans provided by lenders such as banks, savings and loans, mortgage companies that are affiliated with bank holding companies, banks of the Farm Credit System, or insurance companies regulated by the National Association of Insurance Commissioners. Loans are guaranteed up to 90% of the loan's outstanding principal.

- The **benefits** of the USDA's loan guarantee program is that it provides incentives to lenders to offer improved terms or reduced restrictions. It could result in **lower interest rates, better loan-to-value requirements,** or **lower debt service coverage covenants.** It can also be combined with the USDA's direct loan program.
- The **constraints** are that it is **only available to rural health centers** and it has **one extra layer of approval.**

Additional information on the USDA's programs can be found at **www.rurdev.usda.gov.**

Other sources of credit enhancement could include a letter-of-credit from a bank or bond insurance, such as for tax-exempt bonds. A local hospital, the city or state, or other partners of health centers may also be willing to provide a guarantee to enhance a health center's credit worthiness.

PART 3

Appraising Different Financing Options

Qualitative Comparison of Debt Options

On a qualitative basis, it is important to consider the tradeoffs between the different debt options, when evaluating your choices. The chart below provides a comparison of some of the major debt financing sources and how they compare on major factors such as complexity, upfront costs, and size of borrowing among others.

Financing Source	Complex?	Time to closing	Upfront Costs	Interest Rates	Size of Borrowing	Term
Commercial Loan	Low – Medium	1 – 3 months	Medium	Medium	Small – Large	5–10 yrs.
Tax-exempt Bond	High	4 – 6 months	High	Low	Medium – Large	20 – 30 yrs.
NMTC Loan	High	4 – 6 months	High	Low – Medium	Medium –Large	7 yrs+
Community Development Loan (CDFI)	Medium	1 – 3 months	Low	Low –High	Small	3 – 7 years
Government Program	Medium	4 – 6 months or more	Low	Low	Small – Medium	3 – 40 years
Owner Financing	Low	1 – 2 months	Low	Low –High	Varies	Varies

Depending on your center's project financing needs, these factors may be weighted differently. Health centers with larger projects may be willing to undertake a more complex financing with greater upfront costs if they are able to spread those costs over a longer term with more favorable interest rates. On the other hand, a health center with a smaller borrowing amount may want to pursue a less complex option that could close more quickly with lower upfront costs. The interest rate savings of a more complex option may not pass through to a smaller borrowing amount because the upfront costs would be spread over a lower amount.

Quantitative Comparison of Options

Once a health center has narrowed the options for financing its capital project, it is important to conduct a numerical comparison of the terms. It can be difficult to truly compare the impact of different options on a health center's financials unless a comparative numerical analysis has been executed. Each project will need its own financial assessment based upon the availability of options in its area and the

particular needs of the project. In many cases, this step will be the comparison of actual offered terms received from potential funders as part of an initial request for proposals. With a numerical comparison, a health center can put its alternatives on an even playing field to determine which one will provide the best results in the long run and how each of the individual options will affect the bottom line.

Terms to Compare

In general, the following terms and assumptions will be needed to make a useful comparison of financing options.

Financing Source	Comparison Terms	✓
Conventional Loan	Interest rate	❑
	Term	❑
	Amortization	❑
	Upfront or commitment fees	❑
	Legal Fees	❑
	Borrower's counsel	❑
Bank Qualified Tax-Exempt Bonds	Interest rate	❑
	Term	❑
	Amortization	❑
	Upfront or commitment fees	❑
	Bond counsel fee	❑
	Issuer's fee	❑
	Issuer's bond counsel fee	❑
	Borrower's counsel	❑
Tax-Exempt Bonds*	Interest rate	❑
	Term	❑
	Amortization	❑
	Upfront or commitment fees	❑
	Bond counsel fee	❑
	Rating agency fee	❑
	Trustee fee	❑
	Underwriter's fee	❑
	Underwriter's counsel	❑
	Letter of credit fee	❑
	Letter of credit bank counsel	❑
	Borrower's counsel	❑
New Markets Tax Credit	Price per equity credit, which determines the amount of equity in the deal	❑
	Overall percentage of fees and reserves required (typically ranges from 4 – 10%), including CDE, legal and accounting fees, in addition to other back end fees.	❑
	Structure of long-term hard debt compared to "soft" debt	❑
	Estimated interest rate on both portions of debt**	❑
	Term	❑
	Borrower's counsel	❑

*The interest rate reflected for tax exempt bonds should be the all-in rate for the bonds which would include any annual trustee fees and rating agency fees, among others. If utilizing an interest rate swap, the cost of the swap should also be considered.

**Most NMTC deals will be structured as interest only for the first seven years. Comparison of terms from other financing vehicles with NMTC options usually is limited to that seven year period.

Analyzing the Comparison

Once the information on the previous terms has been collected, a comparison of inflows and outflows of the cash from the different financing sources can be analyzed. The interest rates and fees applicable to each source should be compared on a present value basis in order to determine which structure could produce the most benefit to the community health center. When the different options are put side by side, there are several key issues on which many alternatives vary that the health center will want to evaluate.

- **Permanent Loan Amount:** This amount will vary by option due to the types of costs that can be included as part of the financing. Tax-exempt bond options usually have a higher permanent loan amount due to the cost of issuance. For tax-exempt bonds, including the bank qualified, many of the costs of issuance can be rolled up into the total bond amount. For NMTC transactions that intend to leverage or roll in the grant amount, the permanent loan amount will be the total of the entire project, plus the applicable fees and reserves.
- **Interest Rates:** These will vary greatly among the options. Interest rates for the bonds should reflect the all-in rates for the correct comparison. The all-in rate will include any letter-of-credit, trustee fees or rating agency fees that are charged on an annual basis. While the interest rate is important, it is critical to compare all the other options in addition to the rate. In most cases, decisions are made based upon factors other than just the interest rate.
- **Term:** Based upon the timeframe offered by each funding source, as well as the interest rate swap options available, the term of each financing could vary. The analysis should try to normalize the terms of the different options, so that all options are compared on an even playing field. This may require some assumptions to be made about refinancing terms for the options so that all options can be compared over equal time periods.
- **Amortization:** These will be based upon the terms received from the different banks. The amortization schedule should include any interest-only construction period, which is also important as part of these comparisons.
- **Annual Principal and Interest Payments:** The total annual payment is calculated for each option based upon the applicable interest rate, term, and amortization.
- **Out of Pocket Fees:** These costs can be initially estimated but then should be updated based upon the potential funder's proposals. It will be important to include any costs that could be rolled up into the cost of issuance and could be included as part of the permanent loan amount for the project.
- **Total Cash Paid:** Comparing the amount of cash paid will provide an initial assessment of the total cash outlay required by the different options. This amount would include all cash paid out as part of principal payments over the life of the financing, all interest payments including the interest-only period during construction, as well as any out of pocket costs. The lower the cash paid, the potentially greater the benefit of the financing for the health center.

- **Net Costs:** Comparing net costs evaluates the actual expenditure a health center will make to obtain the financing. Total costs will include the total amount spent on interest over the life of the loan plus the out of pocket costs. These costs should then be netted out of any benefits returned upon at the end of the borrowing period. These benefits could include debt service reserve funds or the expected equity portion of a New Markets Tax Credit Transaction. The higher the net costs, the more expensive a particular option is.
- **Net Present Value of Cash Flow:** By calculating the net present value of the cash flows, a health center can determine which financing option may provide the most benefit to the center over the life of the financing. For this calculation, the higher the net present value, the greater the benefit.
- **Comparison Over the First 7 Years:** For NMTC transactions, it is important to compare all options over the initial seven year tax credit period. The total cash paid, net costs, and the net present value of cash flows can all be calculated and compared only for the initial seven years. Next, a comparison of all transactions over their entire lifespan, with assumptions made for refinancing of the NTMC transaction following the tax credit period, can be completed.

The financial calculations described above will give a health center a numerical and objective way to compare various financing options. However, it should be noted that the most lending arrangements can hinge upon other important non-numerical factors. While the interest rate, fees, and terms are important for comparison, many deals fall through due to more subjective factors such as the other covenants associated with lending arrangements or the relationship with the banks. While a numerical comparison will help in making a decision, the final choice should not be based solely on the monetary factors.

PART 4

Putting It All Together

Health Center Examples

One helpful way to navigate this process is to look to other health centers as examples. The following is a selection of completed health center projects that have used a mixture of funding sources discussed in this manual. Highlighted are projects that utilized New Markets Tax Credits, Tax-exempt Bonds, a USDA Direct Loan, and debt financing using a Loan Guarantee. As previously discussed, many health centers need to piece together a variety of sources in order to complete their capital project. While each example highlights a main source of funding, it is important to note the assortment of sources that each project contains.

Primary Care Providers for a Healthy Feliciana, Louisiana: New Markets Tax Credits

Health Center Background:

Primary Care Providers for a Healthy Feliciana (PCPFHF) of Louisiana provides quality, affordable health care to all residents, including those without health insurance. PCPFHF operates RKM Primary Care in Clinton, five school-based clinics in East Feliciana Parish and WBR Primary Care in Port Allen. RKM Primary Care, the core site, also provides comprehensive and integrated dental health, behavioral health/substance abuse services, and access to a discount prescription program. Following the Gulf Coast Hurricanes, RKM Primary Care was instrumental in treating evacuees throughout the area.

RKM Primary Care opened its original facility, a 3,700 square foot building, in 2003. Significant growth required the addition of two portable buildings in 2005, one offering dental services and one for administration.

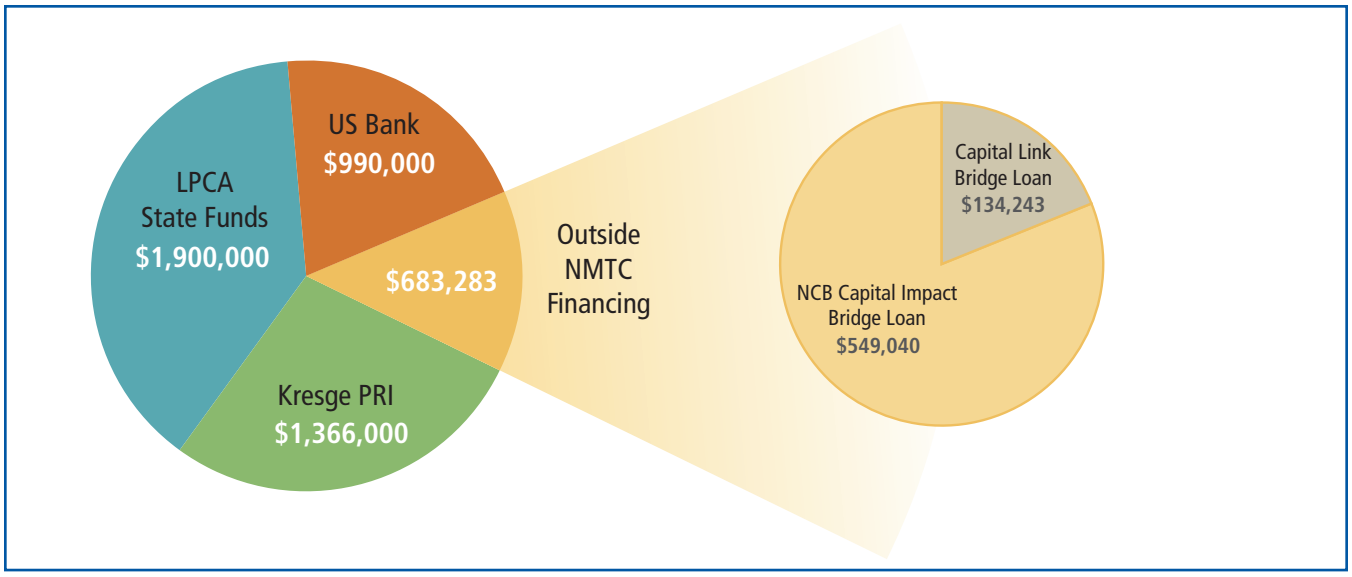
The Capital Project:

RKM is building a $4.9 million, 19,968 square foot clinic behind its existing clinic. When completed, this project will enable the center to double its staff from 24 to nearly 50 and triple the number of patients it currently serves. Currently, PCPHF can accommodate 6,000 patients and 15,000 visits. By 2012, the center will serve more than 18,000 patients and 45,000 visits.

Financial Components:

The project was financed with $4.9 million of which $4.26 million was structured in New Markets Tax Credit loans through Capital Link's Community Development Entity (CDE) with a low 3.47% interest rate payable interest-only for 7 years. Partners in the NMTC transaction included the Kresge Foundation, which provided Capital Link with a Program Related Investment and the state of Louisiana, which provided the Louisiana Primary Care Association (LPCA) with a grant for the project. In turn, Capital Link and the LPCA used the foundation and state funds to make low-cost leverage loans for the project, thereby leveraging the tax credit equity provided by US Bank. Capital Link and NCB Capital Impact also made loans outside the NMTC structure to provide bridge financing for expected grant funds. Additionally, through a put/call option, it is likely that the loans funded with the LPCA and US Bank funds will essentially be forgiven at the end of the 7-year tax credit period. Structuring the financial package in this way enabled the health center to rely less on grants yet keep the debt low-cost. A key component was the use of foundation and state funds, which kept the debt costs below market rate for the health center — thereby allowing it to take on a more substantial project than would otherwise have been feasible.

The Financing Structure:



Thundermist Health Center, Rhode Island: Tax-Exempt Bonds

Health Center Background:

Providing medical, dental, and social services to nearly 20,000 patients annually, Thundermist serves low-income individuals from three sites in Rhode Island. Started more than thirty years ago, it is a founding health center of the Neighborhood Health Plan of Rhode Island.

Thundermist is the only provider in the region offering primary care services to the uninsured on a sliding scale, and its patient population is disproportionally poor; over three quarters of its patients are at or below 200% of the Federal poverty level. The health center is also the sole provider of dental care in its service areas, operating two of only five dental clinics in the entire state.

Thundermist strives to remove any cultural barriers to accessing primary health care. This includes having bilingual Spanish and Laotian staff, as well as capacity to provide translation services for additional languages. The health center also maintains the largest team of social workers of any health center in Rhode Island.

The combination of high patient demand and a merger with another health center led to capacity constraints and operational efficiency challenges. Thundermist sought financing to acquire and renovate a new facility.

The Capital Project:

Thundermist Health Center planned to undertake a $6.8 million capital project to purchase and renovate a new facility and move its main clinic site. Prior to contacting Capital Link, Thundermist had already signed a Purchase and Sales agreement for a 40,000 square foot building. Thundermist planned to renovate the building for its use based on estimates of $125 per square foot.

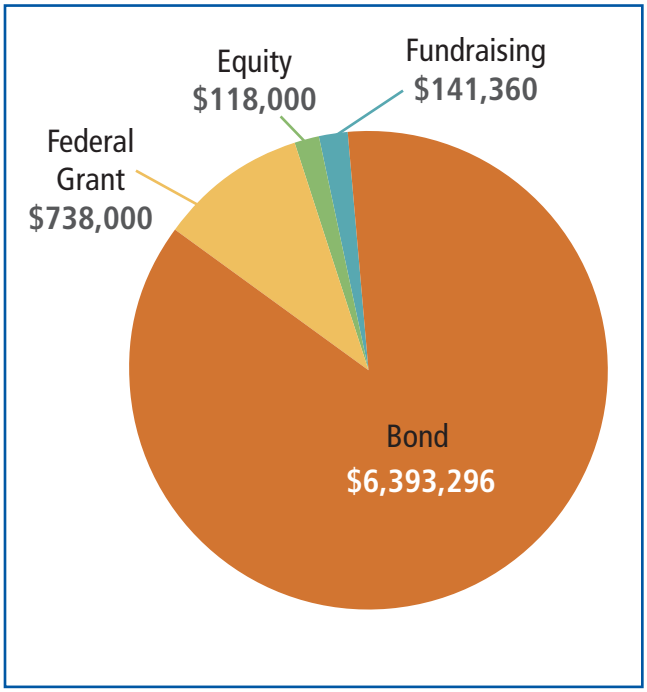
Financial Components:

Financial components of this project were expected to include $2.4 million in loan financing, $1 million from the sale of the current building, $500,000 from fundraising and $460,0000 from cash reserves. Assuming that project costs were $6.4 million, Thundermist would need to obtain $2 million in additional financing.

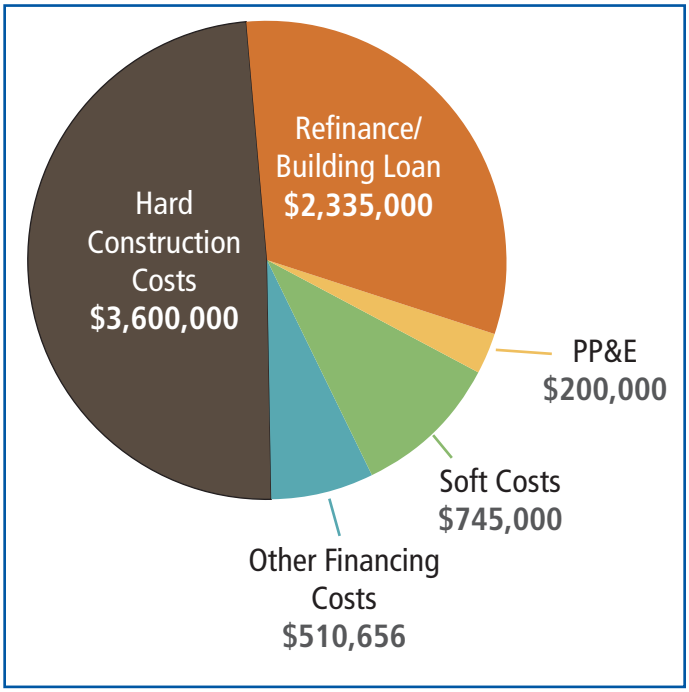
The actual cost of the project was slightly higher than expected. With additional planning, Thundermist determined that the total project cost would amount to $7.4 million. Capital Link helped Thundermist access nearly $6.4 million in tax-exempt bonds, which funded 86 percent of the project. A Department of Health and Human Services grant accounted for another 10 percent of the costs. Thundermist was able to make up for the shortfall through its own equity and fundraising efforts.

Thundermist Health Center, Rhode Island

Financing Structure:



Uses of Funds:



Goshen Medical Center, North Carolina: USDA Direct Loan and Grant

Health Center Background:

Goshen Medical Center, Inc. (Goshen) is a non-profit community health center that provides affordable, comprehensive primary health care services to families and residents of its service area. Goshen operates in a federally-designated Medically Underserved Area.

Goshen's service area encompasses Duplin, Sampson, and Wayne counties in south-central North Carolina, which is an economically depressed region. Approximately 41% of Duplin County's residents have salaries at or below the 200% level of the Federal poverty level. The area unemployment rate has topped 7%, and it is home to one of the largest migrant farm worker populations in the state of North Carolina.

Goshen provides care to over 10,000 patients in over 34,000 patient encounters at its five sites in Faison, Greenevers, Mount Olive and Buelaville, which each provide 51 hours of service per week. These visits are provided by a total staff of 46 FTEs, including physicians, nurses, nurse practitioners, other medical professionals, and other staff.

Goshen could not adequately serve the growing needs of its community, especially in the area of OB/GYN and pediatric services, without expanding capacity. Major gaps for large numbers of underserved women and children were evident; approximately 40% of women who needed such care needed to leave Duplin county for care, or deferred treatment until the last minute for economic reasons. In order to

accommodate this need for expanded medical services in the low-income community, Goshen embarked on a medical expansion project that would allow the health center to provide a greater range of services to more patients.

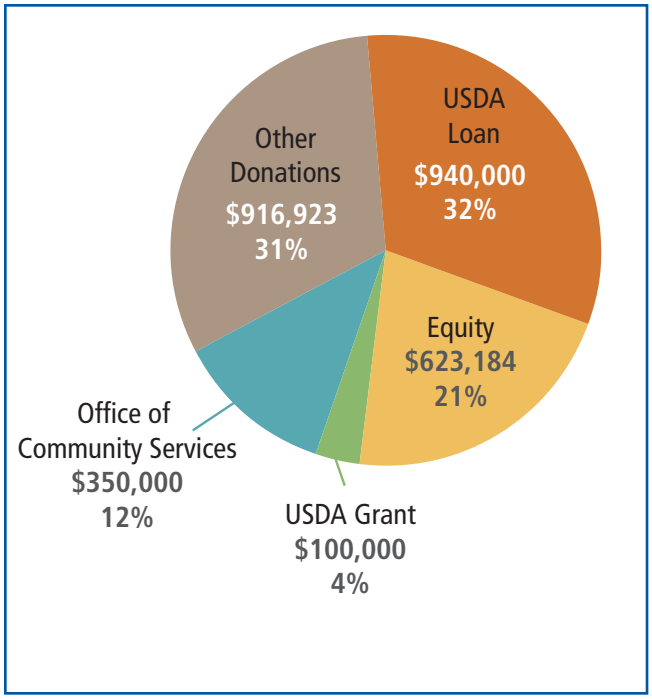
The Capital Project:

Goshen's medical expansion program involved several separate components, including the renovation and expansion of OB/GYN services and administrative space at its main site in Faison, renovations to the Mount Olive site, and upgrades to its medical records area and service vans. The project involved renovation of 4,385 sq ft of "old" facility and 4,020 sq ft of new construction, which, when combined, would allow Goshen to serve a larger portion of its low-income service area.

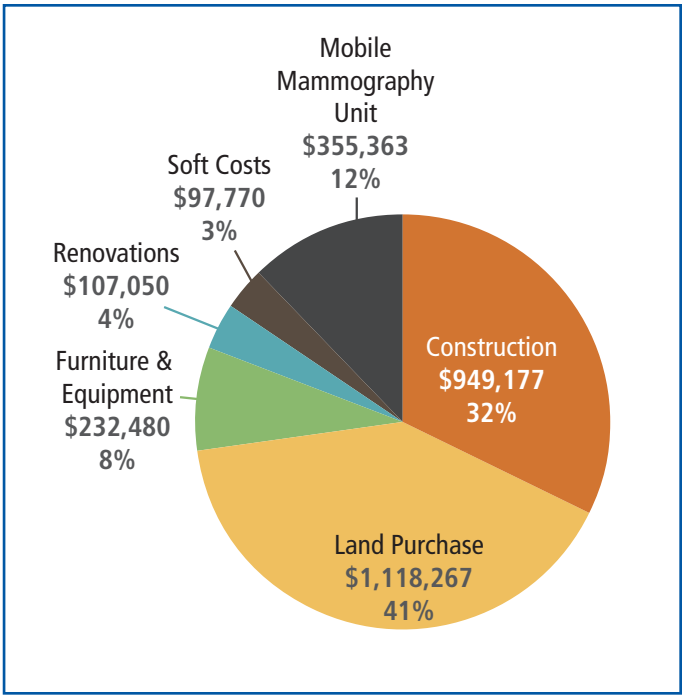
Financial Components:

The greatest single contributor to the funding mix was a USDA loan, at 32% of the capital. The health center also contributed its own equity, at 21%. The Office of Community Services grant, facilitated by Capital Link, accounted for about 12% of all funding. Over 40% of the funds were used to purchase land for new construction as well as expansion. Thirty-three % of funds were used in construction. The mobile mammography unit, paid for by a grant from the Avon Corporation, accounted for slightly more than 12% of the total project costs.

The Financing Structure:



Uses of Funds:



Baltimore Medical Systems, Maryland: Loan Guarantee

Health Center Background:

Baltimore Medical Systems, Inc. is a Federally Qualified Community Health Center (FQHC) with seven primary care and one specialty care practice sites, and five school-based clinics throughout Baltimore City, Maryland, providing comprehensive primary care services to the underserved. Founded in 1984 when it assumed operations of four small primary care clinics run by the Baltimore City Health Department, BMS has grown into the largest FQHC in Maryland and is a significant primary care resource for Baltimore City and County.

The health center had physically outgrown the original Belair Road Community Health Facility (BRFHC) site and was not able to meet the growing need in the community for high quality, affordable health care services. In addition, the original site was situated on the first and third floor of a building with an operating bank located on the second floor in between its clinical operations. This layout created tremendous operational inefficiencies and was inconvenient for patients who must travel between floors for services. The facility, occupied in 1993, was inadequate for further expansion or reconfiguration. In addition, the building owners notified the health center of their intention to sell the building with no guarantees that a new owner would continue to lease space to the health center. Relocating BRFHC increased the service delivery space by approximately 44%, and allowed the health center to grow and develop its existing services, as well as bring on new services.

The Capital Project:

Relocating the BRFHC operations to a nearby site allowed the health center to serve an increased number of uninsured residents in the Belair/Edison community who had limited access to primary care resources. As compared to its old facility, the new facility on Erdman Avenue is a one-story building with approximately 10,800 square feet of continuous space. The new site on Erdman Avenue, which is next door to the older facility, was renovated into a modern, state-of-the-art facility. The relocation and expansion enabled BMS to expand access to its primary care services, add mental health services and add space to be used for patient and community education.

Financial Components:

Baltimore Medical Systems planned a capital project of $2,147,500 to relocate its Belair Road Community Health Facility. BMS secured a $1,280,000 commitment from BB&T Bank for debt financing contingent upon receiving a Loan Guarantee from the HRSA. The health center also secured $283,500 in appropriations funding and applied to two other grant agencies for an additional $584,000 in grant funding to be used toward this project. Financial projections demonstrated the health center's ability to support a loan for this project while generating a narrow profit margin. While the health center projected to operate at break-even or better, BB&T Bank required the health center to secure a Loan Guarantee from the HRSA. The health center sought and obtained a loan guarantee for 80% of the $1,280,000

purchase price of the building ($1,024,000). By securing an HRSA Loan Guarantee, the health center was able to obtain a loan with BB&T Bank at favorable interest rates and loan terms.

The Financing Structure:

The health center was able to complete the project with a loan-to-cost ratio of 60%. As with most capital projects, the majority of costs were used in real estate related costs (54%), followed by construction costs (36%).

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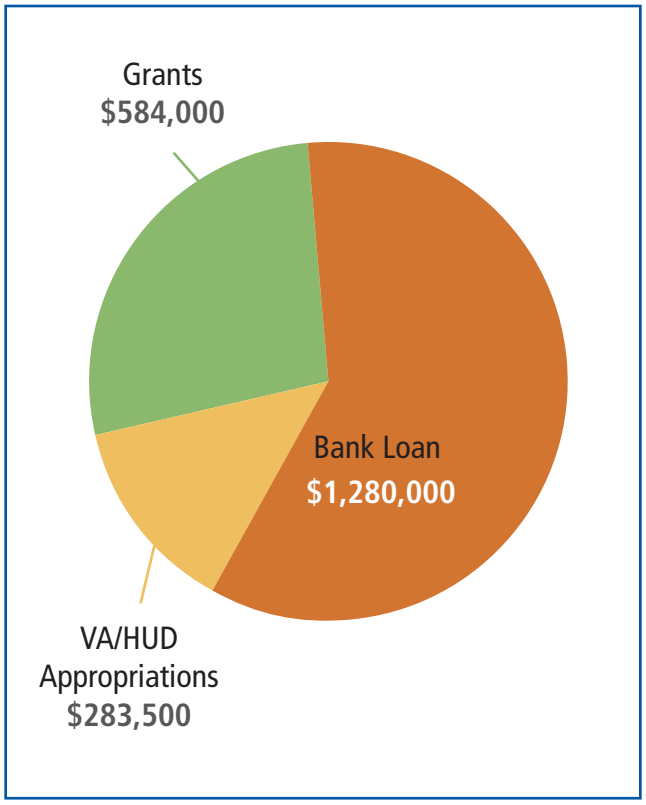
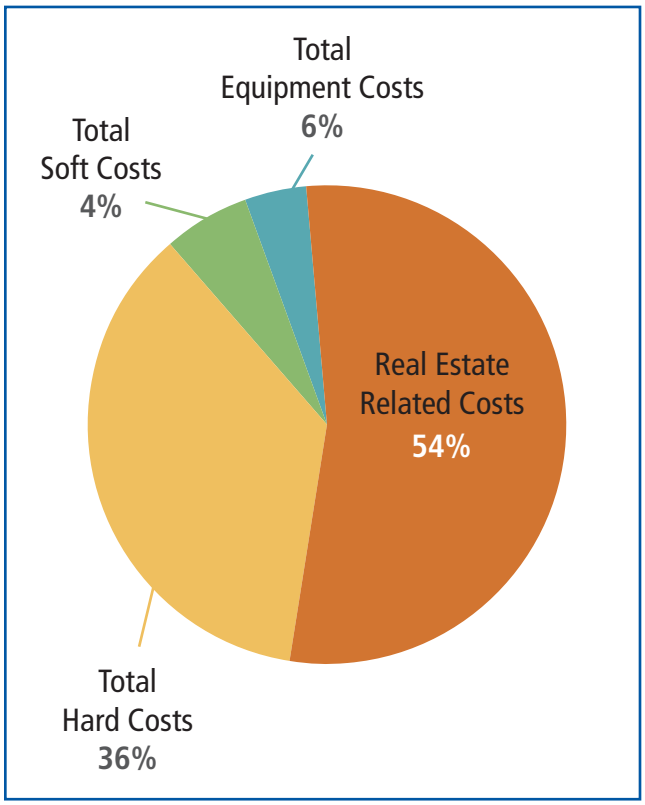


Uses of Funds:



You Drive the Process

It is essential when completing a complex capital project and utilizing multiple financing sources that health center management be the driver in the financing process. You should consider all the financing options that may be applicable to your project — and not just focus on the most obvious. You should also stay on top of what your health center's current debt capacity is and understand what is needed to either become or stay credit worthy. By undertaking all the steps within this manual, a health center should have the tools to narrow down its choices for financing a particular project and should be ready to evaluate specific financing proposals.

Once a health center has decided upon its most likely sources, Capital Link recommends that the health center conduct lender Request for Proposals (RFPs). RFPs allow a health center to approach several different types of organizations and funding sources to obtain letters of interest or term sheets that contain specific information about the products and terms that they would have available. An RFP is a good way for a health center to gauge the lender's interest in its project, as well as obtain specific information on the types of lending structures, interest rates, terms, and even covenants. Because most deals are not decided solely on the interest rate, responses to an RFP could provide information on the loan-to-value requirements, prepayment penalties, or fees required by different organizations.

Because sooner-is-better-than-later in terms of lining up financing sources for a capital project, it is important that you do not shortcut the initial planning process. Feasibility analyses, program and staff planning, and design elements are key parts of refining the project budget and helping to develop a workable plan of finance. It is also important to keep in mind your health center's internal capacity and make sure you have the resources to conduct these steps properly, or supplement with additional help where needed.

Capital Link is available to work with health centers throughout the capital development and financing process. The types of services available to health centers include market assessments, preliminary feasibility analysis, program and staff planning, space planning analysis and financing assistance services. Throughout the financing process, Capital Link can assist health centers in determining their debt capacity, identifying available financing options, completing financial projections and a business plan, and conducting lender RFPs. Capital Link services are flexible depending on your organization's individual planning and financing needs.

Getting Help

About Capital Link

Capital Link has assisted health centers in obtaining low-cost capital debt and equity resources since 1998, initially developing a credit-enhanced tax-exempt bond program for Massachusetts health centers and then expanding our efforts to obtain financing from numerous sources, including conventional lenders, CDFIs, tax credit sources (NMTC and historic), foundations and several state-based loan and grant funds. In certain circumstances, we are also able to provide direct loans to fill funding gaps. We have worked with health centers in 50 states, the District of Columbia, and in Puerto Rico. This funding has allowed the centers to develop more than 1.6 million square feet of space and serve at least 2.5 million patients per year.

Capital Link provides comprehensive financial assistance in order to plan for and secure the most competitive financing option for its proposed facility project. Capital Link may provide all of or some combination of the following services depending on the type of financing the health center chooses for the project:

- **Development of Preliminary Financial ForecasT.** The Forecast estimates the center's Revenues and Expenses, based on estimated patient visits, project payor mix, assumed staffing levels and estimated project costs.
- **Identification of an optimal financing structure for the project,** which may include multiple financing and credit enhancement sources. This begins with a discussion of a number of financing options including, among other sources, conventional loans with or without a HRSA or USDA guarantee, New Markets Tax Credit Financing, and tax-exempt bonds.
- **Financial projections and all needed updates.** Financial projections are a critical evaluation tool for determining project viability. Financial projections incorporate the additional revenues as well as expenses resulting from the proposed project and give the health center an informed assessment of its financial capacity to afford the project.
- **A complete business plan tailored for the intended financing source(s).** Capital Link works with the health center to develop a complete business plan/feasibility study to address the general evaluation criteria of both grant-making organizations and lenders.
- **Applications for credit enhancement, if deemed necessary.** Depending on the agreed-upon financing strategy, Capital Link works with the health center to prepare all necessary application materials for any needed credit enhancement sources, including the HRSA Loan Guarantee Program or applications for bank letters-of-credit or bond insurance as necessary.
- **Negotiations with lenders.** This work includes not only working with the health center to negotiate term sheets and commitment letters, but also assisting with resolving inter-creditor issues between multiple lenders as necessary.

- **Finalizing funding commitments and general assistance** to the health center throughout the closing process. We can act as an advisor to your center throughout the closing process, facilitate communication and follow up with your lenders, and help to resolve the various financing-related issues that inevitably occur during the closing process. Essentially, we remain on "your side of the table" until the financing is closed.
- **Direct Loans:** As a Community Development Financial Institution (CDFI), Capital Link provides direct loans in certain circumstances to help health centers close funding gaps and leverage other sources of capital.

Contact Us

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